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The IRS

Sucks

**If you think paying your taxes
is bad, try working at America's
most unloved agency** p50

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**“I had people stand up
and talk about how there
used to be 12 people
on the help desk
in their area and now there
were three.**



**I told employees,
‘Now you know what it’s like
to be a taxpayer
trying to contact us’”**

p50

**“There are
no rules in
hairstressing”**

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**“She puts her boy out
and says, ‘Look at my small
boy, I don’t want to die
with my boy. Please
don’t shoot the boat’”**

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**“You go out with an
empty basket, and
you come back with
an empty basket”**

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Cover Trail

How the cover gets made

Domestic Cover

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"The cover is on the IRS. We spoke to current and former employees about the increasing challenges of working there."

"I can imagine. We could do a shoot that conveys the soul-crushing frustration and overwhelming bleakness of tax season."



2

"So does this represent an accountant, a person doing her own taxes, or an IRS agent?"

"Think of it more as a general manifestation of tax pain. Now we just need to craft a headline that somehow puts this pain into words."



International Cover

1

"The cover is on refugees who are perishing while trying to cross the Mediterranean."

"OK, I'll stop complaining about taxes now."



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Opening Remarks

Games Insurers Play

By David Armstrong

Dave Stow, 71, strains to push the wheelchair carrying his 250-pound son, Bryan, over ramps and into the basement of St. Joseph's Catholic Church in Capitola, Calif., for its Friday fish fry. Bryan Stow is greeted by ladies who kiss him, men who hug him, and a 103-year-old woman who grabs his hand and asks if he is walking yet.

Four years ago, Bryan Stow was a strapping paramedic who spent his days off biking with his son and daughter. That was before March 31, 2011, when he and three friends made the mistake of wearing San Francisco Giants garb to an Opening Day game against the rival Los Angeles Dodgers at Dodger Stadium. They were harassed and threatened. Afterwards, two Dodgers fans beat Stow so savagely in a parking lot that doctors had to induce a coma to save him. He was hospitalized for seven months.

Stow, 46, now has a scar running from the left side of his forehead to the back of his head. On the right side, a shunt to drain fluid from his brain protrudes from his skull. The thick hair he once fussed over is now patchy and thin. Stockings on his legs prevent life-threatening blood clots.

The beating drew national attention to sports hooliganism. It's also brought to light a virtually unknown aspect of the legal system that cuts compensation to victims.

Stow was sucker-punched twice: first by his assailant, then by his health insurer.

Although a Los Angeles Superior Court jury awarded Stow \$18 million from the Dodgers and his assailants last year, he has yet to receive any money. In a bizarre twist, the Dodgers' liability insurer, ACE Property and Casualty Insurance, stands to net \$1.6 million from a side deal in the case.

It's all because Stow's health insurer is entitled to a huge slice of the settlement, even before he is paid. Federal law, upheld by a recent U.S. Supreme Court case, gives insurers the right to recoup medical costs caused by a third party—in the face of state laws that prohibit it. "This is what people pay premiums for," says Stow's ex-wife, Jacque Kain. "To worry about some insurance company taking what is his is absurd."

The centuries-old concept is known as subrogation and is applied in areas such as property insurance. An insurer, for instance, might seek to be repaid by the maker of a faulty furnace that caused a fire in a building the company covered. In recent years, subrogation has mushroomed into a multibillion-dollar source of funds to offset costs for private health insurers as well as Medicare and Medicaid. Medicare reaped almost \$2.5 billion last year, aided by a 2007 law that requires the



Four years ago, Bryan Stow was severely beaten at Dodger Stadium. He has yet to be compensated

federal insurer for the elderly to be notified of any legal settlements paid to its beneficiaries so it can subrogate the funds.

Such medical liens have reduced and delayed compensation in several cases—including the thousands of patients who suffered heart attacks or strokes from diabetes drug Avandia and the 1,000 Montana residents sickened by asbestos from a mine. “It is extremely frustrating for people who are sick, or dying, or who have loved ones who have died and are desperately in need of money,” says Allan McGarvey, an attorney representing some of the asbestos victims.

The liens have spawned companies and law firms that identify cases and, representing insurer interests, pursue patients who have received court settlements. A unit of Xerox recovered more than \$1 billion for health-care clients in a recent three-year period. Optum, owned by insurance giant UnitedHealth Group, is a major player.

Insurers and employers say getting back money in these cases helps lower premiums for all members of a group plan. University of South Dakota law professor Roger Baron disagrees. He says research shows the recovered money does little to reduce rates while increasing executive pay and shareholder payouts. “It would

be wrong to think that the insureds benefit from subrogated recoveries, because they don’t,” says Baron, who’s consulted for injured people facing health-care liens.

All but two states either ban subrogation outright or limit how much insurers can collect. Unfortunately, many employers provide health insurance as an employee benefit under the Employment Retirement Income Security Act, or Erisa, which is a federal law. Congress specifically designed Erisa to supersede any state statutes related to employee benefit plans. More than 90 percent of workers with medical coverage at the largest U.S. corporations are insured this way, according to the Kaiser Family Foundation. Hailed at its passage in 1974 for safeguarding employees’ pension plans, Erisa now helps deny or reduce compensation to workers injured through someone else’s negligence.

Stow received his insurance through an Erisa plan. So did James McCutchen, a US Airways mechanic badly injured in a 2007 highway wreck. When US Airways demanded repayment of \$66,866 it spent on his treatment—a figure slightly exceeding the \$66,000 he netted in a settlement after paying his lawyer—McCutchen refused to pay. He argued the US Airways lien was unfair because he wasn’t fully compensated for his injuries. A federal appeals court agreed, calling it a “windfall” for the airline.

In 2013 the U.S. Supreme Court sided with US Airways, ruling that as long as the health plan’s contract with employees specifies that it can be reimbursed for medical costs in these situations, it has a legal right to collect. Most employees have no idea these provisions exist.

Stow and his family certainly didn’t. As a paramedic for American Medical Response, a subsidiary of Envision Healthcare, Stow paid a \$334 monthly premium for the insurance coverage that was a perk of the job. After the attack, his family initially didn’t worry about the costs, knowing he was insured.

Then Envision demanded repayment of the more than \$3.4 million it paid for Stow’s treatment. His mother, Ann, couldn’t believe it. She asked her attorneys how the insurer “could get away with this,” she says. “The thing is, it is not illegal.”

The Stows had another surprise when they sued the Dodgers and the assailants. During the civil trial last year, Envision quietly assigned its rights to the \$3.4 million to the Dodgers’ liability insurer, ACE, at the discounted price of \$1.8 million.

The jury ordered the Dodgers to pay \$13.9 million. ACE then sent a check to Stow’s lawyer, Thomas Girardi, deducting \$3.4 million for the medical lien that they purchased at a discount. The maneuver

would effectively allow the team’s insurer to realize \$1.6 million from its lien deal.

“It’s disgusting,” says Girardi, who returned the check and is refusing to pay the lien. Stow’s legal team expects ACE to file a lawsuit to collect the \$3.4 million. Given the Supreme Court decision, Stow faces an uphill fight. “The problem now is the law is pretty clear with the McCutchen case,” says another of Stow’s lawyers, Christopher Aumais. The “options are severely limited,” he adds.

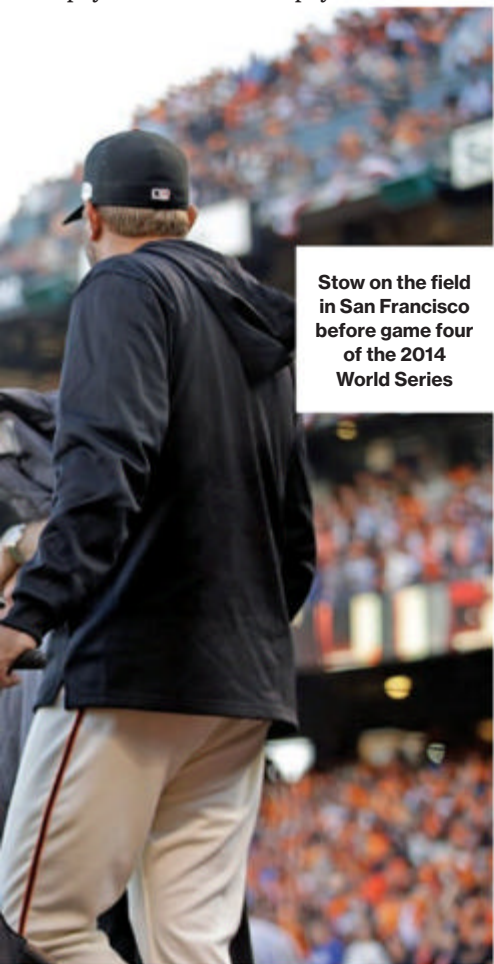
Stow’s attackers are responsible for the other \$4 million of the \$18 million judgment, but no one expects they will ever pay. Louie Sanchez, who jumped out from behind a car, punched Stow from the back and kicked him in the head several times, pleaded guilty to one count of mayhem and was sentenced to eight years in prison. Co-defendant Marvin Norwood pleaded guilty to a count of assault and received four years of jail time.

Stow also owes his lawyers \$3.6 million. San Francisco General Hospital, where Stow was transferred from Los Angeles, has filed its own lien of \$1.2 million for care not reimbursed by his health insurer, according to Stow’s lawyers.

Unless he wins his long-shot effort to nullify or reduce the multimillion-dollar insurance lien, Stow will be left with \$5.8 million, far short of what he’s likely to need for a lifetime of care. An expert hired by the Stows pegged his future medical costs and rehabilitation at more than \$30 million.

Envision says that “fortunately” its plan provided Stow with medical benefits. It didn’t comment on the sale of the lien to ACE. The Dodgers’ insurer said in a statement that “acquiring medical liens is common practice that is regulated by the health-care industry. By acquiring a lien, lien purchasers also acquire the risk of default on the lien.”

To accommodate Stow, volunteers built a ramp from the driveway to the front of the modest home near Santa Cruz, Calif., that his parents bought in 1975. Famous supporters—from Pearl Jam’s Eddie Vedder to many current and former San Francisco Giants—have done their best to lighten the burdens that come with taking 56 pills each day to ward off seizures, pain, and complications from the beating. On April 16, Stow is scheduled to throw out the first pitch at the home opener of the San Jose Giants, a minor league affiliate of the big league team. He’s been practicing with his dad in the backyard, and he plans to get up from his wheelchair and make his way onto the field using a walker. He won’t throw from the mound. Sixty feet is an unthinkable distance. But he’ll throw to the catcher. And he plans on tossing a strike. **B**



Stow on the field in San Francisco before game four of the 2014 World Series

The Most Necessary Republican Candidate

Rand Paul may not to win the presidency, but his ideas could change the GOP



It's highly improbable, to put it politely, that the junior senator from Kentucky will be the next president of the United States. Yet Rand Paul's campaign, which was announced on April 7, is not quixotic. To the contrary, Paul's candidacy matters.

Quite aside from the merits (or absurdity) of his ideas, Paul is pushing his fellow Republicans to question both their politics and their policies. And the country benefits when it has a strong two-party system that forces Democrats as well as Republicans to clarify their thinking.

Even when he's wrong, as he is on the need to audit the Federal Reserve, the senator rarely repeats the lazy slogans that mark so much political debate. Meanwhile, his skepticism about the surveillance state, like his skepticism that U.S. military engagement is a corrective to seemingly every foreign circumstance, is a valuable contribution to the Senate (and will make life uncomfortable not only for many of his fellow Republican candidates but also for expected Democratic nominee Hillary Clinton).

In addition, tone matters. Paul generally has the bearing of a happy warrior, engaging his fellow citizens rather than heaping contempt on opponents. It's a temperament that serves him and U.S. politics well, and one that some of his more surly primary opponents should emulate.

In that vein, Paul's efforts to expand the Republican brand to young people and racial minorities are both brave and necessary. Critics have questioned the sincerity of his appeals to black audiences, which included a speech at Howard University a year ago that received unflattering reviews. But Paul's outreach is valuable even at the level of symbolism and showmanship.

Symbols matter; so does showing up. The U.S. faces a difficult future if its two main political parties grow more racially polarized. In a speech at the University of California at Berkeley, Paul said his party must "evolve, adapt, or die" given demographic realities. Similarly, his support for sentencing reform and questions about his party's efforts to make voting more

difficult suggest the possibility of new pathways to new voters.

The danger is that Paul's ambition will constrain his usefulness. Shortly after he questioned Republicans' focus on combating virtually nonexistent voter fraud, for example, Paul retreated, perhaps fearful of alienating his party's base. He can do far more good stretching the Republican Party's ideological straitjacket than he ever will do wearing it.

The renewal of the Republican Party cannot happen without some serious awkwardness and conflict. Paul may be an imperfect vessel of GOP hopes. But to the extent that he challenges some of the orthodoxies inhibiting the party's evolution and opens it to more diverse views, he is an invigorating addition. Welcome to the 2016 race, Senator.

Obama's Stingy Clemency

He says too many prisoners serve unjust terms. Why commute just 22 sentences?

President Obama has said that far too many federal prisoners are serving longer drug sentences than they deserve. He just can't seem to find them.


A year ago, to much fanfare, the U.S. Department of Justice announced that it would expand its clemency criteria and devote dozens of lawyers to review the applications. There's certainly no shortage of possible applicants: Almost half the 209,000 inmates in the federal prison system are serving time for drug offenses—and almost half that total population is serving sentences of 10 or more years. Sure enough, some 6,500 clemency applications were received in the last fiscal year, nearly triple the record.

On March 31 the president revealed the results (so far) of this yearlong effort: As part of his commitment to "bring greater fairness and equity to our justice system," the White House announced, the president was commuting the sentences of a grand total of ... 22 prisoners. To explain why Obama issued the commutations, the White House released a statement criticizing mandatory minimum sentences for producing overly long prison terms. But were there only 22 for whom that was the case?

More commutations may be forthcoming, of course. Still, the meager number suggests one of two possibilities: The current drug-sentencing laws are actually working quite well, or the president doesn't have the political courage to release people from prison who have been there too long.

Surely it's the latter. Drugs laws in the U.S. are draconian compared with most other nations, forcing people into prison for far longer than necessary, useful, or just—at great expense to taxpayers. Obama said that incarcerating nonviolent drug offenders is "breaking the bank." He's right. But he hasn't been willing to do much about it.

The administration understandably prefers to push for new laws that would reduce sentences, legislation that's receiving increased bipartisan support. But until it passes—and there is still plenty of congressional opposition to lighter sentences—Obama ought to have the courage of his convictions. **B**

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GO

► Don't worry, Americans aren't becoming obsessive savers. Count on them to spend

► "Consumer spending is starting to look more and more like a coiled spring"

People are constantly exhorted to save, but as soon as they do, economists pop up to complain they aren't spending enough to keep the economy growing. A new blogger named Ben Bernanke wrote on April 1 that there's still a "global savings glut." Two days later the Bureau of Labor Statistics announced the weakest job growth since 2013, which economists quickly attributed to soft consumer spending. The U.S. personal savings rate—5.8 percent in February—is the highest since 2012. "After years of spending as if there were no tomorrow, consumers are now saving like there is a tomorrow," Richard Moody, chief economist at Regions Financial, wrote to clients in March.

Saving too much really can be a problem when spending is weak. There are only two things you can do with a dollar, after all: spend it or save it. If you spend it, great—that's money in someone else's pocket. If you save it, the financial system is supposed to recycle your dollar into productive investment with loans for new houses, factories, software, and research and development. But if no one's in the mood to invest more and interest rates are already as low as they can go (as they are in much of the world), the compulsion to save can sap demand and throw people out of work.

For the U.S. economy, the good news is that the jump in the personal

savings rate is probably no more than a blip. Three economists from **Deutsche Bank Securities** in New York explained why in a March 25 report called *U.S. Consumers: Still Shopping, Not Dropping*. While noting a "deceleration" in consumer spending, they wrote, "we think that concerns about the outlook for the consumer are overstated." Their model of the U.S. economy predicts the savings rate will fall to 3 percent to 3.5 percent by 2017.

Other economists have also concluded that the spending dropoff is temporary, which is why the slowdown in job growth, to just 126,000 in March, didn't set off many alarm bells. "Consumer spending is starting to ►

◀ look more and more like a coiled spring,” says Guy Berger, U.S. economist at RBS Securities. One sign that consumers aren’t retrenching: On April 7 the Federal Reserve reported that consumer credit rose \$15.5 billion in February, in line with the recent past.

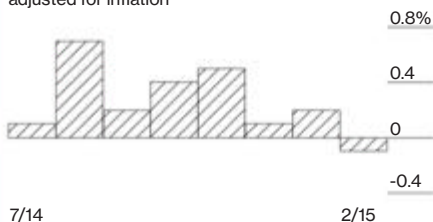
According to Deutsche Bank Securities, the first reason to think consumers will resume spending is

Apocalypse No

Recent economic data have been discouraging, but a long-term view suggests underlying conditions strongly support growth

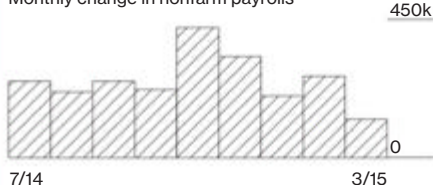
Consumer spending has slowed...

Monthly change in personal consumption, adjusted for inflation



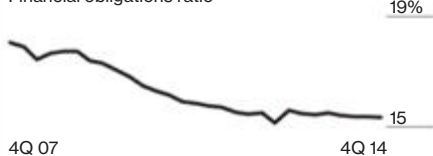
...and job growth has dipped...

Monthly change in nonfarm payrolls



...but consumers are less pinched...

Financial obligations ratio*



...and feel more confident

Bloomberg Consumer Comfort Index, based on Americans' views on the economy



*DEBT SERVICE, RENT, AUTO LEASE PAYMENTS, AND HOMEOWNERS' PROPERTY TAX AND INSURANCE PAYMENTS AS A SHARE OF HOUSEHOLD AFTER-TAX INCOME. DATA: BUREAU OF ECONOMIC ANALYSIS, BUREAU OF LABOR STATISTICS, FEDERAL RESERVE, BLOOMBERG

that their incomes are rising. Annual growth in average hourly earnings has averaged about 2 percent since 2010, which isn't great but does exceed inflation. With more people working as well, aggregate payroll outlays are up 4.9 percent from the past year, according to Bureau of Labor Statistics data.

The rises in stock and home prices should make consumers more willing to live a little, say the Deutsche Bank authors, Peter Hooper, Matthew Luzzetti, and Torsten Slok. They calculate that households' net worth is almost 6.5 times consumers' disposable personal income. That's the highest ratio since before the housing crash. Consumers could also pick up spending if they gain confidence that the drop in gasoline prices is lasting, says Nomura's chief U.S. economist, Lewis Alexander.

No question, the high savings rate depresses spending in the short run. Purchases of durable goods, from cars to couches, remain well below their 60-year average share of gross domestic product. But all that saving helps consumers get their finances in order, which will allow them to satisfy pent-up demand for that sweet new Ford F-150. Fed data show that financial obligations including debt service, rent, and auto leases are about their lowest in comparison to disposable income since 1981. When consumers are ready to borrow more, it won't hurt that, according to the Fed's survey of banks' senior loan officers, banks are easing lending standards.

These factors add up to an optimistic consumer. The weekly Bloomberg Consumer Comfort Index is at its highest since before the 2007-09 recession. Americans' assessment of the buying climate in late March was the best since March 2007. Bad winter weather and West Coast port labor disruptions aside, "I wouldn't say the consumer is deteriorating at all," says Poonam Goyal, a Bloomberg senior research analyst.

The real risk from excess saving is abroad—especially in Germany, as Bernanke, the former Federal Reserve chairman, said in an April 3 post on his new blog at the Brookings Institution, where he's a distinguished fellow in residence. He argues that Germany should promote imports and world growth by upgrading infrastructure, raising wages, and

removing barriers to new housing. Americans, in contrast, can ultimately be counted on to spend what comes in the door. Now is no exception.

—Peter Coy, with Shobhana Chandra and Rich Miller

The bottom line While consumer demand has been soft, economists say households will soon go shopping again.

E-Commerce

In Hard Times, Russians Change Spending Habits

▶ To stretch a ruble, they search the Web for secondhand deals

▶ "What we do has an appeal to consumers in a difficult time"

Jonas Nordlander isn't too bothered by Russia's economic bust. It's been very good to him. The company he co-founded eight years ago, **Avito**, has become Russia's largest classified-ad website. With the ruble's devaluation and the drop in oil exports squeezing their finances, Russians are hawking items big and small on Avito: phones, sofas, TVs, baby strollers, purses, hats, shoes. "All the normal stuff people have at home and now want to sell," says Nordlander, a 42-year-old Swede.

The number of items for sale on the site has jumped 43 percent since the crisis began a year ago with President Vladimir Putin's annexation of Crimea. On March 31, Avito reported that revenue climbed 79 percent last year, to 4.3 billion rubles (\$80.2 million). "Avito is so big now, it's like an index of Russia," Nordlander says.

While Russia's financial markets have bounced back as the price of oil—the country's biggest export—stabilized and tension in Ukraine eased, most businesses are hurting, including multinationals such as brewer **Carlsberg** and carmaker **Volkswagen**. The government forecasts a 3 percent contraction for 2015, a figure some private-sector

analysts say is too optimistic. It would be Russia's first recession since the global financial crisis. With consumer prices rising fast after the ruble's 46 percent decline last year, inflation-adjusted

"I wouldn't say the consumer has been deteriorating at all."

—Poonam Goyal



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1 Грузоперевозки газели, перевозки, вывоз мусора 100 р.



10 Комната 14 м² в 1-к, 2/2 эт. 5 000 р./мес. р-н Дзержинский



5 Форд Эскаорт, крышка двигателя, б/у 350 р. р-н Кировский



1 Новые Apple iPhone 5S 16GB все цвета 23 990 р. р-н Красноармейский



5 Кролики



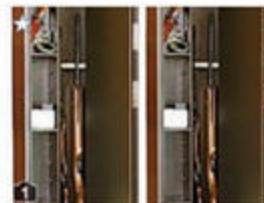
1 Болгарка Интерскол ушм 150/1300 Интерскол 2 700 р. р-н Дзержинский



1 Ведущий специалист по социальным вопросам 15 000 р.



5 Ауди, Фольксваген, кронштейн масла, фильтра, б/у 1 000 р. р-н Кировский



1 Шкаф оружейный ко-037Т 8 937 р. р-н Краснооктябрьский



1 Кофточка с фабрики моды 700 р. р-н Центральный

Deals, Deals, Deals

As Russia's economy stumbles, Avito's online listings include a wider range of goods and services:

Sony laptop, **\$362**

Refrigerator repair and cleaning, price not shown

Garbage removal, **\$1.82**

Room for rent, **\$90.83** per month

Ford Escort engine parts, **\$6.36**

Apple iPhone 5S in all colors, **\$436**

Rabbits, priceless

Angle grinder, **\$49.05**

"A leading expert on social issues," **\$273**

Bracket for an Audi oil filter, **\$18.17**

Gun closet, **\$162**

Teal blouse, **\$12.72**

wages fell 9.9 percent in February from a year earlier, according to the Federal Statistics Service.

Diminished consumer spending has helped fueled a rise in demand for the cheap food sold by France's **Bonduelle**, which cans and freezes vegetables. "What we do has an appeal to consumers in a difficult time," says Chief Executive Officer Christophe Bonduelle. "We sell staples that last." They also cost less than fresh produce. Sales of canned food in Russia jumped 10 percent in 2014, double the pace of the global market, according to Euromonitor International. Bonduelle is seeing what it calls "exceptionally high" sales growth in Russia, where it's operated for more than 20 years. The Russian embargo on European Union food products, enacted in retaliation for the sanctions, doesn't apply to canned goods. The country has barred many canned imports from Ukraine—knocking out some of Bonduelle's major competitors.

Many Russians remain scarred by memories of the ruble devaluation of 1998, which sent the annual inflation rate higher than 100 percent. The price increases today, while a fraction of those back then, still bite. Consumer prices rose 17 percent in February from a year earlier, the fastest pace

since 2002. "In poll after poll," Russians report that "inflation has been the most sensitive issue," says Charles Movit, an economist at research group IHS.

Those fears are good news for **Adamas**, a chain of 250 jewelry shops across Russia. It saw same-store sales climb 40 percent in December as some customers made unusually large purchases. "The faith many people have in gold is rising as instability increases," Adamas Executive Director Maksim Vainberg said in an e-mail. "Unlike home electronics, gold jewelry can be always resold." One Muscovite spent 2 million rubles on gold items, according to the company. And an Adamas store in the Black Sea city of Sochi needed to call in stock from nearby outlets to provide a customer with the 5 million rubles worth of gold chains he wanted.

Turkey has tried to take advantage of Russia's ban on EU food with its own exports. Sales of Turkish meat to Russia rose almost ninefold last year, to about 51 million lira (\$19.8 million). The gain in fruits and vegetables was 21 percent, to about 2.3 billion lira. The Turks' success may be short-lived. Chicken exports have slowed sharply in the last few months as Russia increases local production and allows in less Turkish food under import quotas, says Sait Koca, head of the Turkish chicken

producers' association. Hard-up Russians are spending less on meat no matter what its origin, Koca says. "The consumption just isn't there." —*Matthew Campbell, Adam Ewing, Ilya Khrennikov, and Isobel Finkel*

The bottom line In a period of fast-rising inflation and no growth, many Russians are buying gold jewelry as a savings strategy.

Natural Resources

China Turns to the Sea For Fresh Water

► The government plans to quadruple desalination by 2020

► "In terms of future potential, China may be the most important place"

On the shores of Bohai Bay near the industrial city of Tangshan, construction has begun on an engineering project ambitious even by Chinese standards. Starting in 2019, the facility will remove salt from 120,000 tons of seawater each day. The result will be 50,000 tons of potable water, to be piped 170 miles to Beijing. The capital, located in the arid northeast, has scarce rainfall and

"With fewer options... desalination becomes more competitive."
—Paul Bai, CEO of Aqualyng China

◀ dwindling water reserves.

Home to 20 percent of the world's population but only 7 percent of its fresh water, China has embraced desalination. The central government's Special Plan for Seawater Utilization calls for producing 3 million tons (807 million gallons) a day of purified seawater by 2020—roughly quadruple the country's current capacity. Of China's 668 largest cities, at least 400 already suffer from water scarcity.

Paul Bai, chief executive officer of **Aqualyng China**, a venture between Norway's **Aqualyng** and Hong Kong-based **Beijing Enterprises Water Group**, says China is becoming a crucial market for foreign desalination companies with the latest technology and equipment. "In terms of future potential, China may be the most important place," he says. "The desalination market is very hot right now. The only challenge is the price." Beijing pays 4 yuan (65¢) per cubic meter for tap water; desalinated water will cost 7 yuan, Bai says. "However, with fewer options" for new water sources, he adds, "desalination becomes more competitive." Aqualyng China is building and will operate the Tangshan plant. The International Desalination Association, a Boston-based trade group, reports that China is fifth in the world in installed desalination capacity; two years ago it ranked ninth.

According to state media reports, building the Bohai Bay plant will cost 7 billion yuan (\$1.1 billion); the pipeline connecting it to Beijing, an additional 10 billion yuan. That doesn't include the high electricity costs the plant will incur once it's up and running. The California-based Pacific Institute, an environmental

group, estimates it takes 12,000 to 18,000 kilowatt hours to desalinate a million gallons of seawater. Pumping groundwater to

the surface requires less than 4,000 kilowatt hours per million gallons.

Developed in the 1950s, desalination was until recently used mostly by wealthy desert countries such as Saudi Arabia, the biggest operator of desalination plants in the world. The two main ways to remove salt are reverse osmosis—pushing the water through membranes that trap salt and other particles—and multistage flash, which involves boiling seawater multiple times and collecting salt-free water vapor at each step. The power required to propel water through the fine membranes or repeatedly raise it to a boil accounts for 30 percent to 50 percent of a plant's operating cost.

Although the Chinese have the most ambitious plans, other countries, including Israel, Spain, the U.S., and Australia, have built or are building substantial facilities. As California's drought forced Governor Jerry Brown to announce rationing on April 1, San Diego was at the halfway point in the construction of a \$1 billion desalination plant, slated to begin converting Pacific seawater into 50 million gallons of potable water daily by 2016. It will be the largest desalination plant in the Western Hemisphere.

The amount of power consumed by these plants concerns environmentalists. Washington-based World Resources Institute, a think tank devoted to the environment, warns that the high power demands of desalination will encourage more coal-burning and urban smog in China's northern cities.

Coal-powered desalination isn't the only option. The Perth Seawater Reverse Osmosis Plant, which opened in 2007 in Western Australia, draws energy from the state's Emu Downs Wind Farm. And in January 2015, Saudi Arabia's state-owned technology company **Taqnia** and Spanish energy company **Abengoa** announced construction of the world's first solar-powered desalination plant, near Khafji. —Christina Larson

The bottom line Some 400 cities in China face serious water shortages. Desalination may provide relief, but energy costs will be high.

Sanctions

Iran's Middle Class Plans For Life After a Deal

▶ They're celebrating in the streets but still buying dollars

▶ "I know that it's not going to be immediately all right"

One of the first things Leila Daneshvar did after Iran agreed to a framework for a nuclear accord was to contact European suppliers that had shunned her company because of the sanctions imposed on the Islamic Republic. Trade restrictions had forced Daneshvar to rely on Chinese suppliers to make the medical rehabilitation equipment her Tehran-based company sells. Sanctions that cut off Iranian banks from the global financial system meant she had to fly with cash to Beijing and Shanghai to pay suppliers in person. Now European

MORTEZA NIKOUBAZL/ZEINA PRESS

Wages Who Gained, Who Lost

Which countries had the best or worst wage growth after the global financial meltdown? We've charted the cumulative gains or losses for 75 countries, based on inflation-adjusted data, from 2008 to 2013. The West mostly registered minute advances in pay; wages shrank in Italy and Iceland. Much of Latin America had solid growth as China bought the region's iron ore and copper. —Mark Glassman

Greece

The economy contracted by a fourth; joblessness is now

26%

U.K.

Household incomes have begun to recover since 2013, as have perceptions of the country's finances

Latvia

The ex-Soviet republic laid off thousands as it slashed government spending to join the euro zone

U.S.

Average wages rose a paltry

1.4%

Finland

At the start of the century, it was home to Nokia, the biggest mobile phone maker in the world; those days are gone

Canada

The number of unemployed people grew

28%



Of the 12 nations with wage growth between zero and 3 percent, nine are in Europe



Foreign Minister Mohammad Javad Zarif on his April 3 return to Tehran from Switzerland

suppliers say her requests are under consideration. “Finally the gates open,” she says. “I know it’s not going to be immediately all right, but we’re happy that things are moving forward.”

Daneshvar is a member of Iran’s much-battered middle class, which has been waiting for sanctions to end so they can rebuild careers and businesses at home. After the interim agreement was announced, thousands took to the streets to celebrate what many see as a milestone in the quest to end the country’s pariah status. A survey by the Islamic Republic News Agency said 82.6 percent of Iranians expressed “optimism” and “happiness” over the accord.

Stocks in Tehran rallied 3.2 percent after the announcement, even though negotiators aren’t expected to reach a final agreement until June to curb Iran’s nuclear research in exchange for easing sanctions. The deal faces opposition from Israel, conservatives in the U.S., and hardliners at home.

The previous government, led by Mahmoud Ahmadinejad, focused on helping poor Iranians, to earn their

political allegiance. His government distributed stock in privatized firms, dubbed justice shares, to low-income households and the families of those killed in the war with Iraq. Middle-class Iranians who weren’t his core supporters were mostly neglected. In 2012 and 2013, Ahmadinejad’s last years in office, the rial, Iran’s currency, lost more than two thirds of its value against the dollar as families turned to gold and foreign currency to safeguard their savings.

The administration of President Hassan Rouhani has stabilized the currency and reduced inflation to 15 percent. That’s still the second-highest in the Middle East after Sudan, International Monetary Fund data show. As the economy emerges from recession, growth in non-oil industries remains well below the level needed to create enough jobs. In downtown Tehran, foreign-exchange traders on the unregulated market say the framework accord hasn’t weakened demand for dollars as customers wait to see what negotiations yield in June. “That’s when you know it’s a deal and not an understanding,”

says Khosrow Abdi, a trader.

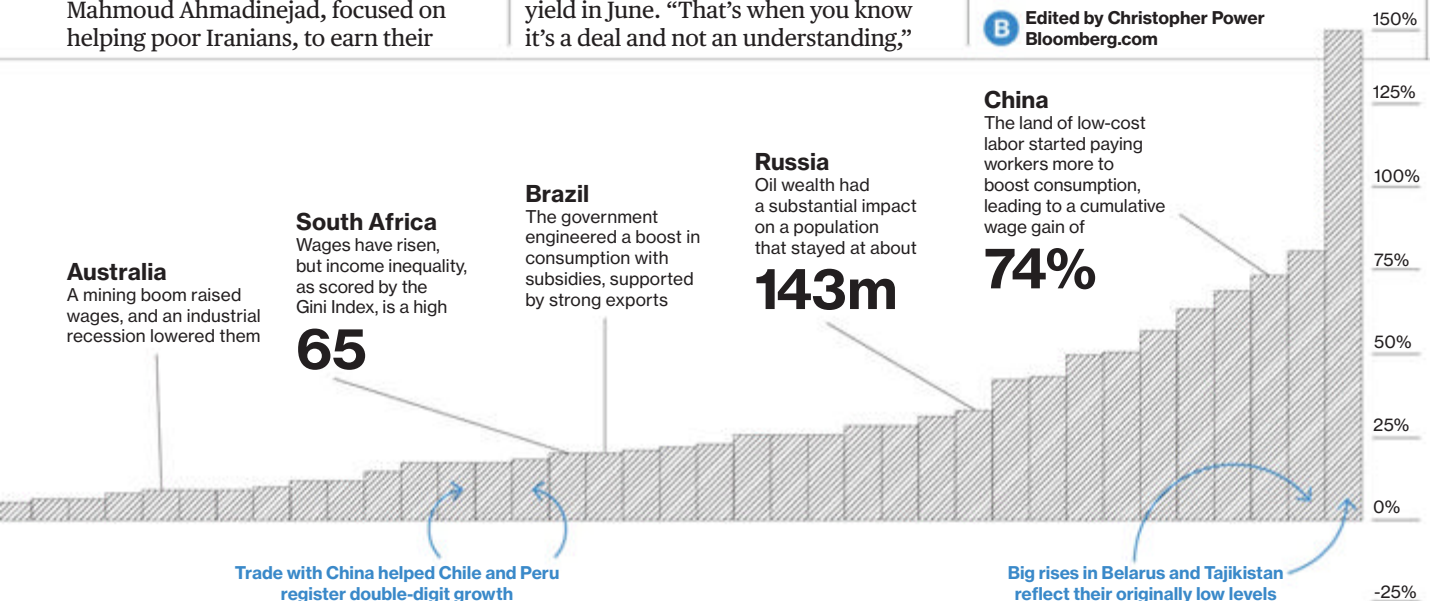
Private manufacturers and importers have been squeezed hard by the sanctions, which increase transportation, insurance, and transaction costs: Unlike state-owned companies, they have no government aid to fall back on. Iran’s university graduates often emigrate instead of seeking careers at home. Tehran’s Enghelab Square daily becomes a market where fixers prepare and translate the documents needed to move abroad. Those who study overseas often don’t come home. A 2012 survey by the Washington-based National Science Foundation said 89 percent of Iranian doctoral students remained in the U.S. after graduation.

Municipal worker Ali Reza says it’s a challenge to make ends meet on his monthly income of 14 million rials (about \$500), half of which he earns working overtime. “I control the household expenses, and it’s been really bad at times,” says his wife, Masoumeh. “You go out with an empty basket, and you come back with an empty basket.”

Despite the continued hardship, the mood has changed. “Difficulties and lack of hope in the future had made Iranians very frustrated,” says Shahnaz Khonsari, an art gallery owner. Now “a beautiful feeling of optimism is palpable in Tehran. You see people smiling at one another and saying, ‘Hey! It did happen!’” —*Ladane Nasseri and Golnar Motevalli*

The bottom line Middle-class Iranians hope a definitive nuclear pact will help restore their purchasing power and revive their businesses.

B Edited by Christopher Power
Bloomberg.com



April 13 — April 19, 2015

Exxon Needs Friends in High Places

► CEO Tillerson is well connected in Russia. Tapping its promising wells there is the problem

► “There are only so many sufficiently large opportunities in the world ... and Russia is one”

It was a moment of triumph for the chief executive officer of **ExxonMobil**. Almost a decade into the job, Rex Tillerson learned in September 2014 that the costliest well in the company's history had struck oil a mile beneath the icy seas off the Siberian coast. It was what the industry likes to call an elephant—as much as a billion barrels, then worth about \$97 billion. Exxon's Russian partner, **Rosneft**, estimated the ocean floor around the \$700 million well could hold more crude than the entire Gulf of Mexico. Tillerson had bet big on Russia, and it looked like he'd finally silence concerns that Exxon's crude output had plummeted for most of his tenure.

Yet no sooner had the company made the energy industry's most promising find in 45 years than Exxon was packing up the drilling rig and going home. The short-lived victory had been snatched

away by economic sanctions imposed in response to Russian leader Vladimir Putin's support of Ukrainian rebels. The setback reignited debate over whether Tillerson, who along with Exxon declined to comment for this story, bet too much of the company's future on Russia, a country led by a former spy with a bent toward military interventions and economic nationalism.

Tillerson's options got more complicated on April 8, when **Royal Dutch Shell** offered \$70 billion for Britain's **BG Group**. Its move could force Tillerson back into the big-ticket dealmaking that he has avoided for the past half-decade. And with just two years before he reaches mandatory retirement at 65, Shell's deal could make it more difficult—or expensive—to achieve his goal of leaving Exxon in a better position than when he took over.

The bittersweet Arctic win shows the complexity of that challenge. “The tenure of Mr. Tillerson has been made of light and shadows,” says Leonardo Maugeri, the former head of strategy for Italian oil producer **Eni**. Russia, he says, is “one of the shadows”—a risky foray made at a time of deceptively high prices and mounting political tension.

Russia is looking like Tillerson's second big swing and miss since he became CEO in 2006. In 2010, Exxon paid \$35 billion for shale gas producer **XTO Energy**, its biggest deal in more than a decade. The ink was barely dry when North American natural gas prices crashed amid a supply glut that shows no sign of abating.

The challenge for Exxon is that it's so big that only huge bets such as XTO and Russia can allow it to maintain its size. Average daily crude production during



Tillerson's tenure has fallen by 421,000 barrels, or 16 percent—equivalent to all the oil pumped daily from the largest U.S. oil field at Prudhoe Bay, Alaska.

There's no risk of the lights going out at Exxon's headquarters in Irving, Texas, for quite some time. The company has a market value of \$357 billion, little debt, and 2014 revenue roughly equal to Taiwan's gross domestic product. The largest offspring of the Standard Oil Trust founded by John D. Rockefeller in the 1880s, Exxon is renowned for engineering prowess and an obsessive focus on long-term planning that keeps it steady amid turmoil. "For all its history, Exxon had a principle: We will never rush when the others are rushing," says Maugeri, now a fellow at Harvard University. Buying XTO so quickly "was a major departure from this philosophy."

Drilling in Russia, however, is in tune with Exxon's long history of extracting resources from some of the globe's riskiest, most isolated reaches. Tillerson helped run the company's Russian operations in the 1990s, including the giant Sakhalin-1 oil project in Russia's Far East. He got to know all the big players, from Putin on down.

Tillerson's boss, then-CEO Lee Raymond, almost made a deal in 2003 with oligarch and opposition figure Mikhail Khodorkovsky to buy a stake in Yukos Oil, then Russia's largest oil company. Raymond was interested only if Exxon would ultimately gain control. Putin, uneasy about Americans commanding a key Russian resource, blocked the proposal. Khodorkovsky was later jailed, and Yukos's best assets were sold to Kremlin-controlled Rosneft. Raymond, who retired in 2005, cooled on investing in Russia.

In 2011, Tillerson decided to risk Russia again by teaming with his old Sakhalin partner, Rosneft. The different approaches of the two CEOs must be judged by their circumstances, says a former executive at a big Exxon rival who asked not to be named discussing a competitor. Abundant exploration options gave Raymond the luxury of skepticism, he says, while Tillerson, after initially dismissing shale drilling as too costly to turn a decent profit, had few Exxon-size alternatives.

In Russia, Tillerson "underestimated the risks and overestimated his

opportunities to influence policy," says Alexander Temerko, the former deputy chairman of Yukos, who now lives in the U.K. "It turned out that not everything that's in the interest of Exxon is also in the interest of governments."

Tillerson's Russian ties go deep. He first met Putin in 1999 on remote Sakhalin Island, and in 2013 the Russian president gave him the Order of Friendship, one of the nation's highest honors. In 2011, Putin championed granting the Arctic prize to Exxon, believing the U.S. company's experience would help vault Rosneft into the top tier of global oil producers, according to a person with knowledge of the matter who was not authorized to speak about it. Last year, despite the Ukrainian conflict, Exxon completed exploration agreements in the Arctic that quintupled its exposure to Russia. It signed the contracts in May, but by September they were dead letters as a new round of sanctions barred it from drilling those fields. "There are only so many sufficiently large opportunities in the world when you're that big of a company, and Russia is one," says Edward Chow, a former Chevron executive who's now a fellow at the Center for Strategic & International Studies in Washington.

Partly because of the Russian sanctions, Tillerson in March told analysts the outlook for boosting production in 2018 and beyond is murky. The end of a four-year bull market for crude also



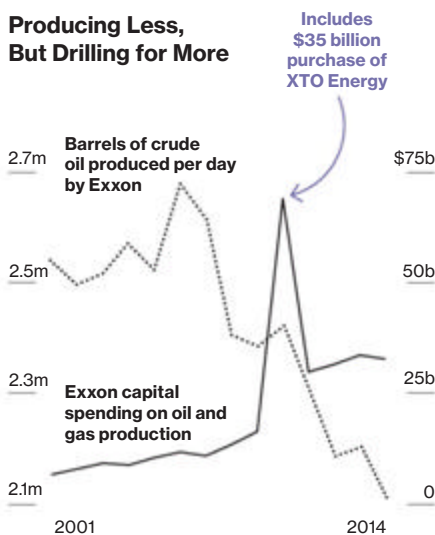
has coincided with mounting exploration failures worldwide, according to Exxon's filings.

The 16 percent decline in crude production since Tillerson took over is worrying, particularly since oil is far more profitable than natural gas. Crude fell to 53 percent of the company's output in 2014, vs. 63 percent in Tillerson's first year as CEO. Exxon's reserves have increased 18 percent during that period, but only because capital spending was raised to what Wolfe Research analyst Paul Sankey calls "eye-watering levels."

Oil industry insiders say Tillerson is again looking to acquisitions, and the crash in oil prices may work to his advantage. "They're in a really good position to take advantage of low prices and try to get some undervalued assets," says Michael Lynch, president of consultant Strategic Energy & Economic Research. "They are a supertanker, but they're also a big shark that can swallow almost anything."

Tillerson said in March that Exxon's financial strength, coupled with the weakened state of smaller players now that energy prices have fallen, presents a golden opportunity for the only oil company with a AAA credit

Producing Less, But Drilling for More



DATA: COMPILED BY BLOOMBERG

◀ rating. Exxon has also repurchased \$226 billion in common shares over the past 16 years that can be used to fund a transaction. Its acquisition priorities hew toward the U.S., including America's expansive shale fields, where oil can be extracted with little or no political risk. Boosting energy from shale would go a long way toward reaching Tillerson's goal of lifting Exxon's total global production 8 percent, to the equivalent of 4.3 million barrels a day, by yearend 2017.

The biggest oil giants missed out on the early years of the shale revolution because the potential didn't look promising enough. Shale exploration is still an uncomfortable fit, says Ian Taylor, CEO of Vitol Group, the world's largest independent oil trader. "The majors' specialty is big, complex projects," he says. "In shale, they can't bring their economies of scale to bear." That's why Exxon managers likely won't be giving up their Russian visas anytime soon. —Joe Carroll and Matthew Campbell

The bottom line Exxon's new well in Russia's Arctic could hold more than 1 billion barrels of oil. For now, sanctions put the find off-limits.

Antitrust

Drugmakers' Patent Tactic Faces a Big Test

▶ A profit protection strategy is under legal assault

▶ "This could really have a devastating effect"

Actavis, maker of the blockbuster Alzheimer's drug **Namenda**, isn't the first pharmaceutical company to attempt what's known in the industry as product hopping or the hard switch. Facing the loss of patent protection and profits on top-selling brands, drugmakers sometimes stop or sharply limit sales of drugs to force consumers to switch to a somewhat modified, newly patented version before generic rivals have a chance to get into the market.

The practice is under the spotlight in a high-profile antitrust case brought against Actavis by New York Attorney General Eric Schneiderman. Last December he persuaded a federal district court to issue an injunction preventing Actavis from halting sales of its

original Alzheimer's drug in favor of a new slow-release version. Actavis has appealed the ruling, and the U.S. Court of Appeals for the Second Circuit in New York will hear oral arguments on April 13.

Namenda, produced by Actavis subsidiary **Forest Laboratories**, is the company's top-earning drug, with about \$1.5 billion in sales last year. With the patent on the old version of Namenda expiring this month, Actavis is intent on building a market for Namenda XR, its once-a-day pill for Alzheimer's sufferers. The patent for Namenda XR doesn't expire until 2029.

"[I]f we do the hard switch and we convert patients and caregivers to once-a-day therapy ... it's very difficult for the generics then to reverse-commute back, at least with the existing Rx's," Actavis Chief Executive Officer Brent Saunders said on an earnings call in January 2014.

Actavis declined to comment for this story. In a statement issued in January, Saunders said Namenda XR offers significant advantages for Alzheimer's patients. He was optimistic the company would prevail in the Second Circuit.

Generic drugmakers, pharmacy chains, insurers, and consumer and public health advocates have long accused brand-name pharmaceutical companies of gaming the patent system to protect their monopolies on popular drugs. In his ruling in December, U.S. District Court Judge Robert Sweet cited Saunders's comments to analysts, as well as investor presentations and internal company e-mails, as proof that the use of the hard switch was anticompetitive.

"This could really have a devastating effect," says Kevin McDonald, an antitrust lawyer at Jones Day, who is defending British drugmaker **Reckitt Benckiser Group** in a similar case in Pennsylvania brought by drug wholesalers and other private plaintiffs over

"Improvement of old products, even if it's just tweaking, can lead to much bigger breakthroughs."
—Kevin McDonald

the anti-opioid dependency drug Suboxone. McDonald contends that his client, like Actavis, is being targeted for making what it believes is a safer, better version of Suboxone. If the Second Circuit fails to stop the New York attorney general's move to "take over

the factory," McDonald says, drug innovation will be chilled. "Improvement of old products, even if it's just tweaking, can lead to much bigger breakthroughs," he says.

Over the past decade, several brand-name drugmakers, including **Abbott Laboratories** and **AstraZeneca**, have faced product hopping-related claims. The outcomes of those cases, all brought by generic drugmakers, insurers, and other private plaintiffs, have been mixed.

Michael Carrier, an antitrust expert at Rutgers School of Law at Camden, says the Second Circuit, as the first federal appellate court to weigh in on the dispute, could have a profound effect on the drug industry. He hopes the court will establish that the hard switch violates antitrust law—and continue to bar Actavis from pulling the old Namenda until this August, when generic substitutes should be available. "It's the only way to remedy the anti-competitive harm," says Carrier, who joined an amicus brief supporting New York state.

If the appeals court does decide that Actavis's hard switch is anticompetitive, many observers say plaintiffs' lawyers who specialize in pharma antitrust claims will be emboldened to sue Actavis and other drugmakers that have engaged in product hopping.

"It would become an invitation for lawsuits all over the place," says University of Iowa antitrust professor Herbert Hovenkamp, who also joined an amicus brief supporting New York's case. And because plaintiffs in antitrust cases can collect treble damages, the costs to defendants, he says, could be steep. "We're talking about hundreds

The More Things Change ...

Suboxone

Manufacturer: Indivior (formerly Reckitt Benckiser)
Original form: Tablet
New form: Film placed under the tongue
Used to treat: Addiction
List price: \$8/film

Doryx

Manufacturer: Actavis
Original form: Tablet
New form: Capsule
Used to treat: Infections
List price: \$35/pill

TriCor

Manufacturer: AbbVie (formerly Abbott Laboratories)
Original form: Capsule
New form: Tablet
Used to treat: Cholesterol
List price: \$9/pill

DATA: SYMPHONY HEALTH, BLOOMBERG INTELLIGENCE

of millions, if not billions, of dollars in damages,” Hovenkamp says.

Drugmakers that have relied on the hard switch to maintain market share could also face a blow to earnings. “If it’s a precedent-setting ruling, it could cost the industry tens of billions of dollars over the next decade,” says David Maris, an equity research analyst at Bank of Montreal. He estimates that Actavis alone could take a 5 percent hit to annual earnings if its plans for Namenda XR are thwarted.

Jerry Avorn, a Harvard Medical School professor and pharma industry critic, says he’s often amazed at the creativity of lawyers for big pharmaceutical companies and won’t bet against their chances of keeping the hard switch alive. “However this goes,” he says, “I think we’re destined to see many more years of patent shenanigans.” —*Susan Hansen*

The bottom line A federal appellate court ruling against Actavis could set off a wave of litigation against big drug companies.

Spirits

Nixon’s China Quaff Goes Mass Market

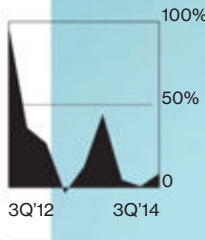
► With pricey gift-giving now frowned upon, Moutai cuts prices

► Ending “the feeling that drinking the liquor is an unobtainable thing”

When President Richard Nixon and Premier Zhou Enlai toasted the opening of China to the U.S. during their historic 1972 banquet in Beijing, it was no surprise that the beverage in their glasses was the searing white spirit called *baijiu* (pronounced “bye-gee-o”) made by distiller **Kweichow Moutai**. Its pricey version of the locally popular quaff had long been a staple of formal gatherings across the mainland. The drink’s vaunted position continued, sending the price of a bottle of Moutai soaring to \$300 in 2012 as baijiu became the go-to gift for officials during China’s dizzying economic boom.

The brand’s wild ride came to an abrupt halt two years ago, when President Xi Jinping’s war on graft made China’s self-proclaimed

Moutai sales vs. prior year



106

The proof level of Moutai brand's baijiu. That's more than 50 percent alcohol

\$23_b

Annual sales of baijiu in China, where it was a fixture at celebrations

national liquor a symbol of boozy revelry and Communist Party excess. After Xi banned the lavish banquets in which free-flowing Moutai had long played a starring role, demand plunged among China’s elite.

That led distributors of Moutai to slash prices by more than half, putting it within reach of urban professionals and curious trendsetters. Baijiu makers have also sought to rebrand the liquor as a sophisticated indulgence, sort of China’s answer to single malt Scotch. To attract converts, Moutai has stepped up its marketing to the masses, sponsoring a 43-part TV series about a legendary Qing Dynasty gunfighter-turned-winemaker who founded the baijiu industry. The company announced in December it also would spend 200 million yuan

(\$32.3 million) to start a division to promote its lower-shelf brands such as Prince and Banquet liquor—costing 300 to 500 yuan—to attract customers not yet ready to shell out more for its namesake tippie. “The new targets for Moutai are middle-age, affluent consumers,” says Doreen Wang, the New York-based global head of the BrandZ unit at consultant Millward Brown.

Recent results suggest the brand may finally be shaking the hangover. Moutai could see sales surge as much as 11 percent this year, according to Goldman Sachs. That’s up from an estimated 1 percent rise in 2014. Guo Chaoren, a distributor in Guangzhou, reported a 20 percent sales jump during Lunar New Year festivities in February, selling out his entire 24,000-bottle supply. “The demand completely exceeded my expectations,” he says. The reason? More affluent Chinese



are starting to see the 106-proof, sorghum-based liquor as something to sip among friends, not just to buy the favor of powerful officials.

While that's welcome news for China's estimated \$23 billion baijiu market, moving the spirit's positioning down market isn't without risk. Moutai's new drinkers are likely to hold back if prices rise too fast again. Yet there are signs that the repositioning is drawing attention for the drink far beyond its traditional strongholds. Bars specializing in the liquor are popping up from Beijing to London. And Lumos, a bar in New York's trendy SoHo area that's devoted to "white spirits" (a direct translation of the drink's name), opened in March with a menu of 60 baijiu cocktails.

China's military and the government account for only about 10 percent of Moutai sales, down from 30 percent two years ago, according to investment bank China International Capital. Falling prices have also helped Moutai win market share from cheaper rivals, such as **Wuliangye Yibin**, growing to an estimated 35 percent of the market held by publicly traded Chinese liquor makers last year, up from 25 percent in 2012.

Analysts predict sales in China of high-end items such as Moutai will stabilize in 2015. "After two years of the anticorruption campaign, a lot of the unusual consumption of high-end spirits has already been squeezed out," says Charlie Chen, a Hong Kong-based analyst with BNP Paribas.

Overall baijiu sales grew 5.5 percent last year, rebounding from a drop the previous year, researcher Nielsen found in a survey of 1,100 Chinese stores. Sales were driven by midrange baijiu, which jumped 63 percent. Bottles exceeding 700 yuan fell 39 percent. As average Chinese consumers become willing to pay more for perceived quality and prestige, Moutai's adherents say the luxury brand will be most likely to benefit. "Moutai is a brand with much culture and history," says Guo, the Guangzhou-based distributor. "It is still the strongest brand in the baijiu industry."

Wang Xi, a 28-year-old banker in Shenzhen, recently bought two bottles for about \$150 each at Sam's Club as personal gifts. Previously he had given the spirit to clients only if his employer, whom he declined to identify, picked up the then-sky-high tab.

"As China's economy grows and our

standard of living rises, Moutai will become more mass-market," Wang Xi says. "People won't have the feeling that drinking the liquor is an unattainable thing. If they want to drink it, they will." —*Liza Lin and Yuling Yang, with Haixing Jin*

The bottom line Moutai's baijiu liquor hit \$300 a bottle in 2012. China's anticorruption push hurt sales and forced price cuts.

Gaming

Maybe Macau's Way Isn't So Bad After All

► Restricting Chinese-style gambling tours, Singapore casinos lose big

► Without junket operators' help, it's "tougher to collect receivables"

Singapore wanted nothing to do with the often questionable gaming middlemen who proliferate in Macau. The gambling houses in Macau get around China's currency controls by relying on so-called junket operators to extend credit to mainland high rollers, a business model that has been linked to organized crime groups known as triads, says Steve Vickers, chief executive officer at risk consultant Steve Vickers & Associates. But lately, Singapore's two casinos appear to be paying the price of their government restricting that setup.

Chinese VIP gamblers patronize both cities—and account for about half of all Singapore gaming revenues, says Grant Govertsen, an analyst at Union Gaming Advisors. And bad debts are mounting in both cities as gamblers have a hard time adjusting to China's corruption crackdown and slowing economic growth.

There's a big difference in how casinos feel the pain, however. In Macau—which, like Hong Kong, is a special administrative region of China—about 180 licensed go-betweens provide credit to their customers and collect the money they owe. Singapore has just three licensed junket operators, who mainly help with foreign travel arrangements. So gaming losses there fall squarely on the casinos' shoulders.

The burden is growing. Casino operator **Genting Singapore** and billionaire Sheldon Adelson's **Las Vegas Sands**,

parent of Singapore's Marina Bay Sands casino, already have reported hundreds of millions of dollars in receivables, or outstanding debts, on their balance sheets. Genting has established a record reserve to cover debts that are uncertain to be repaid. More will probably have to be set aside, according to Union Gaming. Receivables and notes that Genting Singapore is owed but hasn't collected totaled \$787.5 million in 2014, more than doubling from \$369 million in 2010, according to data compiled by Bloomberg. That's about four times the average at Macau's six biggest casino operators.

The junket setup in Macau, the only part of China where gambling is legal, gives gaming houses some protection from such charges. In good times, junket operators take a slice of profits that would otherwise go to the casino in exchange for bringing in groups of high-stakes gamblers with whom they have relationships. In bad times, they shield the gaming company from some of the losses by handling their own collections—with some using everything from public shaming of indebted clients in their hometowns in China to physical intimidation.

"Singapore casinos are dealing directly with the VIP players," says Govertsen. "That makes it a lot tougher to collect receivables because they don't have the typical resources that junket

The Real Action Has Moved East

Gaming revenue in 2014



operators would have to collect such gambling debts.”

Singapore officials didn't want its two casinos to rely on such outsiders. “The business model of junkets is inherently designed to usurp laws and regulations related to lending, money flows, and other elements,” says Jonathan Galaviz, a partner at Global Market Advisors, a tourism consultant. “Singapore didn't want to risk its reputation as an ethical global financial center.”

Singapore is trying to use judicial means to compel dozens of Chinese gamblers to pay up. Last year its two casinos filed 49 lawsuits against individuals in Singapore's High Court for gaming-related debts, up from just two a year earlier. The resorts brought 12 more cases in the first quarter of 2015. Val Chua, spokeswoman at Marina Bay Sands, and Lee Sin Yee, spokeswoman at Genting's Resorts World Sentosa resort in Singapore, declined to comment.

Singapore's Casino Regulatory Authority didn't immediately respond to questions.

Last month, China's government set its lowest annual growth target in more than 15 years, a bad omen for real estate prices. “A lot of these Chinese VIPs have money stuck in property investments, and they're probably having trouble liquidating those assets to pay off those debts,” says Samuel Yin, an analyst at Maybank Kim Eng in Kuala Lumpur.

While junket operators might be helpful in such times, says Vickers, “a major problem ... is that a need for extra-legal services means that many junkets have close links to triad societies.” Those extra-legal services include debt collection and running prostitution rings inside casinos, he says.

A mainland gang in 2005 beat a man to death while seeking repayment of 1.8 million yuan (\$291,000) he lost at a Macau casino. Chinese police handle more than 200 cases annually of illegal imprisonment of gamblers for unpaid Macau debts, according to a 2012 report by the government-controlled newspaper *Xinxi Shibao*. —Jonathan Burgos, with Daryl Loo and Andrea Tan

The bottom line The number of lawsuits against Singapore gamblers who didn't pay debts grew to 49 in 2014, from two in 2013.

Briefs

By Kyle Stock

Too Much Reality

● 📺 ● *Viacom*, the owner of BET, MTV, and Comedy Central, said it would take a \$785 million charge as it writes down the value of underperforming reality shows and pays severance for hundreds of terminated positions. The media conglomerate also halted its \$20 billion share buyback program and reorganized its sales, marketing, and creative divisions. It plans to pour resources

into data analysis. ● 🚗 ● The French government said it will spend lavishly to keep control of *Renault*. It will plunk down

\$1.3 billion to raise its stake from 15 percent to 20 percent, in a bid to defeat a proposal at an upcoming shareholders' meeting that would end a setup that gives the state two votes

for each of its shares in the carmaker. ● ▶ ● *Google* began laying the groundwork for a subscription service at its YouTube unit, according to an e-mail obtained by Bloomberg. The company has spent more than \$100 million bolstering the video site's original content. According to the proposal, users would pay a monthly fee to see YouTube videos without ads. ● ⚡ ●

Tesla Motors upgraded its base model electric sedan, adding a battery that's 17 percent larger and pushing the starting price from \$71,000 to \$75,000. The new S 70D, which

will have all-wheel drive and come in three colors, will be able to go 240 miles between charges. ● 📱 ● *Samsung Electronics* said its profit is declining more slowly than expected, stabilizing results just as it launches two new smartphone models. The company is moving upscale with its Galaxy S6 handsets, adding new colors and metal cases in a bid to boost profit and distance itself from low-cost rivals in India and China.



Zynga, a struggling maker of video games for mobile devices, said founder Mark Pincus will return as CEO. He replaces Don Mattrick, who has led the company since July 2013. It lost \$226 million in 2014.

The number of skilled worker visas mandated by Congress. Applications passed that mark in one week, prompting the U.S. government to organize a lottery.

65k

CEO Wisdom



“It's getting harder to hire people. That drives wages up, and that's a great thing.”

Patrick Doyle, CEO, Domino's Pizza



Edited by James E. Ellis and Dimitra Kessenides
Bloomberg.com

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Is There a Middle Ground?



► After a spectacular failure in Indiana, conservatives regroup on religious freedom bills

► “There are real people who thought they had certain freedoms, and they’re getting hammered”

Indiana isn’t the only state having trouble with religious freedom legislation. In March, Georgia’s Senate approved a religious freedom bill. Like similar laws passed the same month in Arkansas and Indiana, it expanded protections for people claiming to be acting according to their religious beliefs. Some Democrats said the vote was rammed through committee during a bathroom break, but the bill had overwhelming support on the Senate floor, where it passed 37-15. It then ran aground in the Georgia House, where moderate Republicans sided with Democrats and added an anti-discrimination amendment that the legislation’s sponsors refused to accept. “The term ‘discrimination’ is a very elastic thing that can mean a lot of different things to different people,” says Republican State Senator Josh McKoon, who sponsored the bill. “It really was going to render the underlying bill meaningless.”

On April 2, the legislature adjourned for the year without sending the legislation on to Governor Nathan Deal. McKoon plans to revive his bill when legislators return in January. He says he isn’t concerned about provoking the public backlash that prompted Indiana lawmakers to backtrack on their bill. The difference, McKoon says, is that his bill sticks to the language of the Religious Freedom Restoration Act, the 1993 federal law that’s inspired 21 state sequels. That law declared the government “should not substantially burden

religious exercise without compelling justification.” It was meant to offer greater protections for people who felt that obeying certain laws would go against their beliefs, and like many of the early state RFRAs, it passed with overwhelming bipartisan support. “The federal act provides us with a safe harbor,” McKoon says. Deal, who voted for the 1993 RFRA as a congressman, has made similar comments. “As close as a state can stay to the original language, the safer you are,” Deal told the *Atlanta Journal-Constitution* on April 3. (Through a spokesperson, Deal declined to comment further.)

Christian conservatives who are pushing RFRAs around the country say they come in two models: the Cadillac and the Rolls-Royce. McKoon’s bill, which shields individuals from government intrusion, falls into the Cadillac category. The more ambitious Rolls-Royce versions extend protections for business owners who want to run their companies according to their personal religious beliefs and cover disputes between private parties that don’t involve the government. The bill that Indiana Republican Governor Mike Pence signed on March 26, drawing widespread public condemnation from liberal groups and business interests, was a Rolls-Royce. “I think states will have to count the costs of passing a Rolls-Royce version of RFRA because of what happened in Indiana and Arkansas,” says Bruce Hausknecht, a judicial analyst for

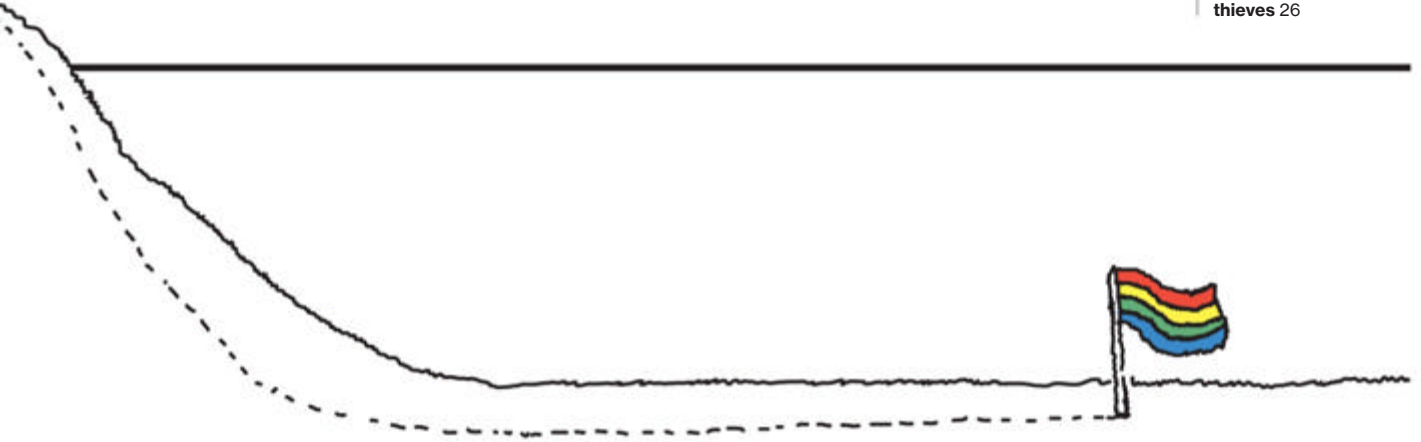
Focus on the Family, the evangelical group. “Everyone recognizes what the Rolls-Royce looks like, but the political differences on the ground in each state necessitate getting done what you can get done.”

Through its political advocacy arm, Citizenlink, and 38 state affiliates known as Family Policy Councils, Focus on the Family has been central to bringing RFRA bills to state legislators. Activists have long settled for Cadillac legislation they could get passed, but recent Republican gains in state houses have emboldened them to push for Rolls-Royce bills. Lawmakers passed them last year in Arizona and this year in Indiana and Arkansas.

The bills drew protests from corporations such as **Wal-Mart** and **Apple** and from liberal advocacy groups. Arizona Governor Jan Brewer vetoed a Rolls-Royce. Arkansas’s Asa Hutchinson refused to sign his state’s until it was amended to remove language extending protections to corporations and covering private lawsuits, turning it into a Cadillac. Indiana’s Pence initially defended his decision to sign a Rolls-Royce before asking the legislature to add anti-discrimination language.

Some legislators who voted for a Rolls-Royce say they didn’t do their homework. Arkansas State Senator Jeremy Hutchinson, the governor’s nephew, cast a party-line vote to pass the

“The federal act provides us with a safe harbor.”
—Georgia State Senator Josh McKoon



bill through a committee review. “In that moment I did vote in a cowardly manner and reflexive manner,” he says. After studying the text, he tried unsuccessfully to defeat it when it went to the Senate floor on March 27, just as the national debate about the Indiana bill was taking off. With thousands of bills to consider, he says, part-time legislators are “relying on your own research or getting input from outside groups, and that’s not ideal.”

The core issue at stake in all RFRA is what happens when a person’s religious convictions conflict with the law. The federal act was written in response to a 1990 Supreme Court ruling that a state unemployment commission could penalize Native Americans for using peyote in religious ceremonies. Justice Antonin Scalia found that while the First Amendment protects the free exercise of religion, it doesn’t exempt believers from complying with a “valid and neutral law of general applicability.” That meant Native Americans wouldn’t get a pass on drug laws, just as Quakers have to pay taxes that support the U.S. military. In 1997 the Supreme Court ruled the RFRA covered only the federal government. That prompted states to begin passing their own bills to cover nonfederal agencies.

The spread of same-sex marriage has prompted Citizenlink and allied groups to use RFRA legislation as a way to allow individuals and business owners to deny services to gay and lesbian couples in the name of religious belief. Several high-profile lawsuits involving businesses sued for discriminating against gay couples have helped elevate the issue. When a photography studio

tried to use New Mexico’s RFRA as a defense for refusing to work for a same-sex couple, a state court rejected the claim because the government wasn’t a party to the lawsuit. To some conservatives, that showed the need for Rolls-Royce RFRA. “I think Christians are beginning to understand, ‘Hey, wait a minute: This is not scaremongering,’” says Ed Vitagliano, executive vice president of the American Family Association, which opposes same-sex marriage. “There are real people who thought they had certain freedoms, and they’re getting hammered.”

The Supreme Court’s 2014 Hobby Lobby decision, which found that RFRA protects some business owners who invoke their religious beliefs to deny employees contraceptive coverage in medical insurance plans, gave conservatives confidence to push for Rolls-Royce state laws. “It’s a matter of figuring out the political landscape in each state,” says Tom Minnery, Citizenlink’s chief executive officer and president.

Liberal groups say even Cadillac language like that being pushed in Georgia has the effect of legalizing discrimination. “It’s being used as a cudgel by religious majorities to evade the enforcement of civil rights law,” says Adam Talbot, a spokesman for the Human Rights Campaign, a national LGBT advocacy organization. The federal RFRA has proven to be a problem in some cases, Talbot says, including one in which a member of the Fundamentalist Church of Jesus Christ of Latter-Day Saints, an extremist sect that split from the Mormon Church, successfully refused to answer some questions in a child-labor investigation.

Georgia State Senator McKoon hopes that, if his bill passes next year, courts will find it covers companies as well as flesh-and-blood human beings, even if it doesn’t say so explicitly in the text. “I believe,” he says, “that the bill would be read as the federal bill was interpreted by the Hobby Lobby decision.” —*Josh Eidelson*

The bottom line Public outcry against religious freedom bills in Indiana and Arkansas hasn’t deterred conservatives from promoting them.

Energy

Coal Is Crashing, But Zombie Mines Won’t Die

► A 1977 law makes it cheaper to keep digging than to close

► “They cannot escape their obligations to restore the land”

On April 16 federal standards go into effect requiring coal-burning power plants to cut the amount of mercury spewing from their smokestacks. Rather than clean up operations, some utilities plan to abandon coal and either switch to natural gas or close. By the end of 2015, about 23 gigawatts of coal power will be off the U.S. market, a 7.5 percent cut.

That’s adding to a crisis for producers. The strong dollar has priced American coal out of the overseas market, while the fracking-driven boom in natural gas has cut into coal’s dominance in the U.S. Its share of the ►

◀ fuel market has fallen to 37 percent from about half in 2007, while prices have dropped 33 percent over the past four years. At least four mining companies have gone bankrupt since 2012, including Tennessee-based **Xinergy**, which filed for Chapter 11 protection on April 6. Even **Peabody Energy**, the largest U.S. coal producer, is struggling. Its shares have plunged 94 percent since their peak in 2008.

Nearly three-quarters of coal mined in central Appalachia—West Virginia, Kentucky, and Virginia—is retrieved at a loss. But rather than stop all operations, struggling producers there are continuing to pull coal out of the earth and sell it to cover debt. Miners will dig up at least **17 million tons** more coal than power plants need this year, according to estimates from Morgan Stanley. “They try to eke out a few more quarters instead of shutting down,” says Stephen Doyle, founder of Doyle Trading Consultants, a Colorado energy consulting firm.

That’s partly the result of the Surface Mining Control and Reclamation Act, a 1977 law that requires companies to return land around closed sites to its original state. The law was intended to “assuage the fears that the beautiful areas where coal is produced are being destroyed,” President Jimmy Carter said at the signing ceremony. (On April 8, Bloomberg Philanthropies said it plans to invest \$80 million in the Sierra Club’s campaign to reduce U.S. coal dependence.)



Prior to the passage of the mining control act, which was vetoed twice by President Gerald Ford before Carter signed it, an estimated 1.1 million acres across the U.S. had been abandoned by strip miners—an area almost the size of Delaware. Under the law, producers who walk away from cleanups are prohibited from applying for permits anywhere else, says Louise Dunlap, co-founder of the Environmental Policy Institute, who was credited by Carter with playing a crucial role in lobbying to get the legislation passed. “They cannot escape their obligations to reclaim the land,” she says.

Under the act, coal companies are required to buy bonds when they start operations to cover their environmental obligations. The bonds generally fall far short of what it costs to comply with the law. Virginia’s **Alpha Natural Resources**, the second-biggest U.S. coal producer by sales, is closing its Appalachian mines as it moves production west to the Powder River Basin in Montana and Wyoming. In a Feb. 26 regulatory filing, the company told investors it has \$640.5 million in unfunded liabilities associated with mine closures because of the 1977 law. An Alpha spokesman, Steve Hawkins, declined to comment.

The bulk of U.S. mining is in Appalachia, where the cost of closing a mine averages \$11 for every ton of coal in reserve, according to research published by mining consulting firm Wood

Mackenzie. That includes not only sealing mine shafts and removing toxic wastewater but also replanting grassland or forest. “You have this really perverse situation where they keep producing,” says James Stevenson, director for North American thermal coal at economic consulting firm IHS. “You’re just shoveling coal into this market that’s oversupplied.” —*Mario Parker, with Eric Roston*

The bottom line Many coal producers lose money, but a law requiring them to restore land makes it expensive to close mines.

Health Care

Everyone Hates How Medicare Pays Doctors

▶ Obama and Congress agree to scrap a system that saved money

▶ “It’s a little bit silly in some ways, and it’s a lobbying bonanza”

Facing an intense lobbying campaign by the health-care industry, Congress is moving to permanently raise pay for doctors who participate in Medicare. On March 26, the House voted 392-37 to pass a bill that would replace the practice of funding pay increases for physicians by cutting spending in other parts of the \$622 billion program, which insures the elderly and disabled. Senate Majority Leader Mitch McConnell said he plans to bring the legislation up for a

In West Virginia, coal companies have to pay

\$9,500

to restore each acre of land disturbed by mining. There are more than 7,500 acres being mined in the state.



vote after members return from recess on April 13, and President Obama has promised to sign it if it reaches his desk. "I've got my pen ready to sign a good bipartisan bill," he said in a speech marking the fifth anniversary of the passage of the Affordable Care Act.

The problem is, the old system was good at doing exactly what it was supposed to do: controlling public spending on health care. As an entitlement program, Medicare's budget rises automatically in response to enrollment and health-care needs. In 1997, Congress imposed a spending formula that triggers automatic cuts in physician reimbursements if overall spending exceeds targets. That first happened in 2002, when physicians took a 4.8 percent cut in Medicare rates. The American Medical Association and other lobbying groups mobilized to make sure cuts would never be repeated. The result was the "doc fix," a regular Washington rite that brings doctors, hospitals, and patient advocates together to negotiate cuts in service charges to avoid triggering reductions in doctors' fees.

The 17 doc fixes passed since 2003 have resulted in lower costs for ambulance services, dialysis, and CT scans. They've reduced spending by \$165 billion, according to the Committee for a Responsible Federal Budget, a nonprofit that advocates for lower national debt. "It always gets derided, because it's annoying and it's flawed," says Loren Adler, the group's research director. "It's a little bit silly in some ways, and it's a lobbying bonanza. That being said, it's accomplished what was intended—it's controlled the cost of Medicare."

The American Medical Association, which spent \$19.6 million lobbying in 2014, argues that the current payment formula is outdated. Getting rid of it, the organization argues, will make it easier to move away from paying doctors based on the number of procedures they perform. "The reforms in this bill will move Medicare to value-based delivery and payment models that are proving to be successful in improving health outcomes and cutting costs in the private sector," said AMA president Robert Wah in a statement.

The new legislation, which will cost an estimated \$170 billion over 10 years, would give doctors a 0.5 percent increase in annual reimbursement rates for five years and then award bonuses for meeting quality-of-care targets. To

\$170.

The estimated cost of new Medicare payment rates for doctors over 10 years

help pay for higher physician rates, hospitals, nursing homes, and rehabilitation centers will see smaller-than-expected hikes. However, hospitals will benefit from doctors' higher fees. "This is a great deal for hospitals," says Paul Heldman, a health policy analyst at the Potomac Research Group in Washington. "They get a major cause of uncertainty off the table."

—Alex Wayne, with James Rowley and Bennett Roth

The bottom line Republicans and Democrats are uniting to get rid of an ad hoc system for cutting Medicare costs that worked.



A Billionaire Brings Polling to British Voters

► The numbers offer a guide for voters in the May 7 election

► "This is all about tackling the credibility gap"

Until this year, people voting for each of Britain's 650 parliamentary seats had to rely on previous election results and national polls to guess which party might be likely to win their district. Now, for the first time, voters in more than 100 swing constituencies will have detailed research showing where each party stands heading into Election Day.

The data comes courtesy of Michael Ashcroft, a billionaire who made his fortune in the home-security business. He's served as treasurer and deputy chairman of the Conservative Party. He began commissioning private polls to help figure out where Tories were going wrong with voters in 2005, when Tony Blair's Labour Party won a third consecutive term. In 2010, Conservative leader David Cameron put Ashcroft in charge of targeting swing seats, and his focus on data and metrics helped the Conservatives win.

Since then, Ashcroft has set himself up as an independent polling expert. He's become one of the biggest commissioners of political polls in the

United Kingdom, though he doesn't disclose which polling services he uses. In March he resigned his appointment in the House of Lords to focus on polling full time. "I like to offer new evidence as to how voters see things, and to provoke discussion and debate," Ashcroft wrote on his website, Lord Ashcroft Polls, where results for swing constituencies are posted. "And if it doesn't sound too pompous, there is an element of public service in keeping politicians on their toes."

The Ashcroft polls, as they're known, are a boon to the right-wing U.K. Independence Party (UKIP), which the polls show running a close second in several districts. In 2010 the anti-immigration, anti-European Union party won 3.1 percent of the national vote but failed to win a single seat. This year, it's polling in third place nationally with about 15 percent of the overall vote, but it needs to come in first in individual districts to win a place in Parliament. Being able to tell people their votes could put the party over the top helps the party persuade voters worried about playing spoiler. "This is all about tackling the credibility gap that affects all insurgent parties—showing you have a realistic chance of victory," says Matthew Goodwin, co-author of *Revolt on the Right*, a study of UKIP.

The Ashcroft data also shows UKIP where to focus its energy. One of its best hopes is Great Grimsby, halfway up England's east coast, which Labour held in 2010 by just 714 votes out of 32,954. An Ashcroft poll found that UKIP, which attracted only 6 percent of the vote there in 2010, is polling at 34 percent, a single percentage point behind Labour. The Tories are trailing in a distant third place with just 20 percent. "There's some evidence that tactical voting increases and becomes more accurate when voters have more information about the likely order of finish of parties in their constituency," says Stephen Fisher, an associate professor of political sociology at Trinity College, Oxford. "But because we haven't previously had lots of polls in constituencies, we don't really know whether they change behavior." —Robert Hutton

The bottom line For the first time, British voters have access to detailed polls on swing seats, and the data may change their votes.

Ripping Off Uncle Sam

By Richard Rubin and Dorothy Gambrell



MONTGOMERY, THE STATE CAPITAL, IS FULL OF PUBLIC AGENCIES HOLDING PERSONAL DATA VULNERABLE TO THIEVES WORKING WITH DISGRUNTLED EMPLOYEES.

A FORMER WORKER AT ALABAMA'S DEPARTMENTS OF PUBLIC HEALTH AND HUMAN RESOURCES STOLE MORE THAN 3,000 IDENTITIES—MOST OF THEM TEENAGERS!—AND SOLD THEM TO TAX CHEATS.

"IF YOU'RE ABLE TO GAIN ACCESS TO THOSE DATABASES AND CAN PRINT THOSE OFF, YOU HAVE, LITERALLY, A STACK OF PAPER THAT YOU CAN USE TO FILE THESE FRAUDULENT TAXES."

DEMAND FOR LISTS OF NAMES AND SOCIAL SECURITY NUMBERS IS SO HIGH THAT THIEVES SOMETIMES SELL THEM TO MULTIPLE GANGS, EVEN THOUGH EACH NAME CAN BE USED ONLY ONCE.

THE SPREAD OF ELECTRONIC TAX FILING MEANS THESE CRIMES CAN BE COMMITTED ON A LARGE SCALE WITH NOTHING MORE THAN A LAPTOP AND A WI-FI CONNECTION.

SOMETIMES, CRIMINALS SET UP PHONY TAX SERVICES TO COMMIT FRAUD.

TAXES DONE RITE

BLEEP BLOP BLOP

AN ESPECIALLY VALUABLE ASSET FOR TAX CHEATS IS A CORRUPT MAILMAN. CRIMINALS WILL FILE FAKE TAX RETURNS USING REAL ADDRESSES AND THEN PAY POSTAL WORKERS OFF TO INTERCEPT THE REFUND CHECKS BEFORE THEY'RE DELIVERED.

"THAT'S NOT GOING TO DRAW THE ATTENTION, NECESSARILY, OF THE IRS"

ONE GROUP PAID A MONTGOMERY POSTAL WORKER TO STEAL MORE THAN 100 REFUND ENVELOPES SENT TO ADDRESSES ALONG HIS ROUTE.

IN PHENIX CITY, ALA., ONE GROUP FILED \$34 MILLION WORTH OF FRAUDULENT RETURNS THROUGH SHAM TAX PREP BUSINESSES.

ALL OF THOSE REFUNDS WERE LOADED ON PREPAID DEBIT CARDS, THE EASIEST AND MOST POPULAR WAY FOR PEOPLE WITHOUT BANK ACCOUNTS TO GET THEIR MONEY FROM THE IRS. THIEVES ALSO PREFER THE CARDS TO TRADITIONAL REFUND CHECKS, WHICH CAN BE DIFFICULT TO CASH.

OFTEN, THE FRAUD ISN'T DETECTED UNTIL THE REAL TAXPAYER TRIES TO FILE.

INVESTIGATORS THEN WORK BACKWARD FROM THE IP ADDRESSES USED TO SUBMIT FAKE RETURNS TO CATCH THE CHEATS.

SINCE 2012, THE JUSTICE DEPARTMENT HAS PROSECUTED MORE THAN 725 IDENTITY-THEFT TAX CASES INVOLVING MORE THAN 1,400 DEFENDANTS NATION-WIDE.

KAMARIAN MILLENDER PLEADED GUILTY*
24 MONTHS

RODERICK NEAL PLEADED GUILTY
51 MONTHS

TAMIKA FLOYD PLEADED GUILTY
WILL BE SENTENCED IN MAY

CHARNESHA ALEXANDER PLEADED GUILTY*
111 MONTHS

VERNON HARRISON FOUND GUILTY
111 MONTHS
*APPEALING

"WHEN A STOLEN IDENTITY IS USED TO COMMIT TAX REFUND FRAUD, ALL TAXPAYERS ARE VICTIMS, AND ALL AMERICANS ARE IMPACTED BY THE LOSS TO THE FEDERAL TREASURY."



“With all our apps
in the cloud, we get
high-quality products
to market faster.

Riverbed makes
it possible.”

Timothy Weaver, CIO



Del Monte Foods is all about quality and value, and that requires business agility and speed. With all their apps in the cloud, Del Monte runs on Riverbed for superior application performance. More than 26,000 customers rely on Riverbed for end-to-end application visibility, optimization, and control. Riverbed.com/performance

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April 13 — April 19, 2015



Two HPs, One Dream

► As the company gets ready to split, its future rests on “the Machine”

► “I’m not aware of anybody with this aggressive of a time frame”

Last year, **Hewlett-Packard** announced it was working on a new type of computer designed to be super-fast, low-power, and capable of replacing a data center’s worth of equipment with one fridge-size box. Dubbed the Machine, the project would combine advanced research from throughout HP’s divisions, the company said, and if each hit its ambitious goals, the Machine could essentially replace today’s standard computer designs. The job sounded tough even before HP said a few months later that it planned to split down the middle, creating one company that sells business hardware and software while the other focuses on consumer PCs and printers.

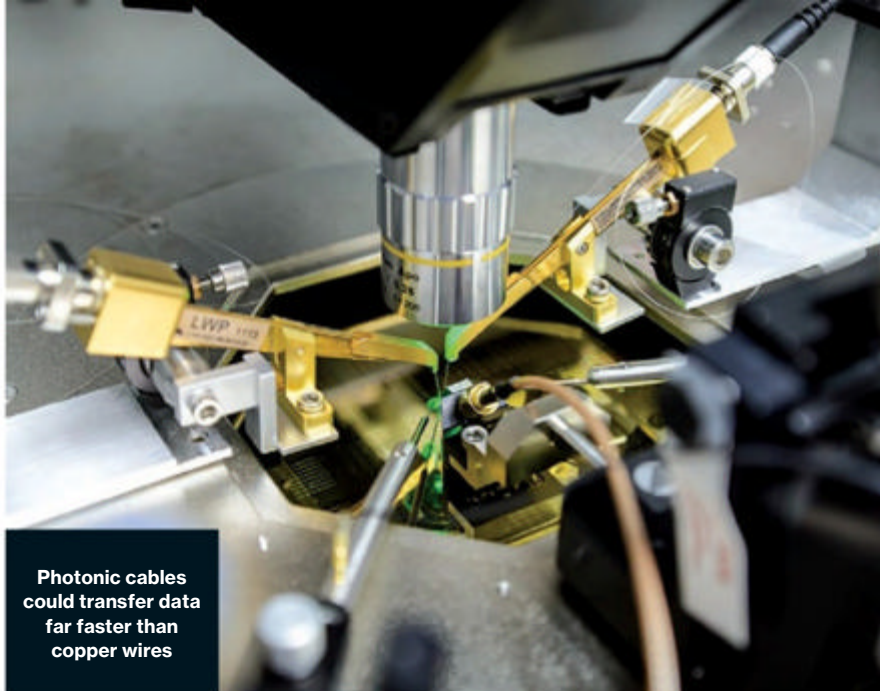
The Machine is supposed to be ready in 2017 at the earliest, and HP has set a Nov. 1 target for the split. So Chief Technology Officer Martin Fink has

drawn up a deal between the two companies that will allow the engineers working on the project to continue collaborating, even though they’ll be working for separate entities. At the same time, the engineers have had to rethink some pieces of the project. Instead of building a brand-new operating system for the Machine right away, they’re first working to customize the free Linux OS and see how far it can take them, Fink says. When the first prototype is completed next year, “there’ll be some ugly spots,” says Kirk Bresniker, chief architect at HP Labs, the company’s research and development arm, which is leading work on the Machine. “I just want something that you can demonstrate and prove is on the right track.”

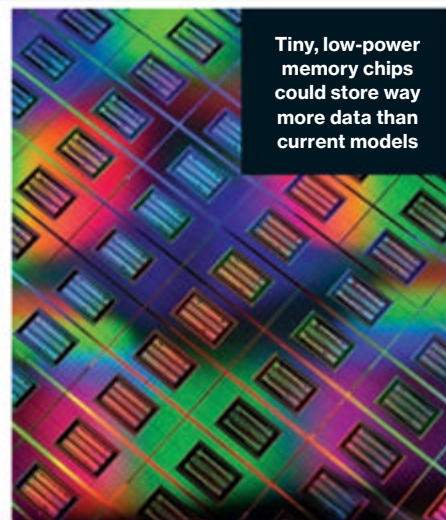
In November, HP will become Hewlett Packard Enterprise (selling

to businesses) and HP Inc. (consumers). Fink, who will be CTO at HP Enterprise, says the Machine has become “a daily point of conversation” with customers and among fellow executives, and HP Inc. engineers will keep working with his team. With the Machine, “I’m desperately hopeful we’ll find that most of everything we do today will get done better and simpler, and we’ll be able to do things we can’t conceive of,” says Fink. HP wouldn’t comment on the financial terms of the collaboration agreement or the Machine’s funding but says it is and will remain HP Labs’ biggest research project.

Plans for the Machine require HP to develop several technologies in tandem: a nanoscale, low-power memory chip called a memristor that’s supposed to vastly increase



Photonic cables could transfer data far faster than copper wires



Tiny, low-power memory chips could store way more data than current models

◀ data storage; a data-transfer system that's much faster than current models because it relies on lasers instead of copper wiring; and software that can put the new components to work. In an early chat about the Machine, Fink says, one client reacted as if he were talking about curing cancer. "That was scary to me," he says. "I don't want that on my shoulders."

If all of those parts come together, the Machine would be able to reinvent the building blocks of every computer on earth, from PCs to smartphones, says Crawford Del Prete, chief research officer for market researcher IDC. Competitors have yet to announce challenges to HP's moonshot. "We're involved in some very advanced, very low-level silicon-level engineering, and you're going to hear about it when it's ready to ship," says Oracle's senior vice president for systems technology, Juan Loaiza. "We don't need to talk about stuff five years from now."

Over the past few months, to get developers used to programming on something like the Machine, HP has begun releasing hardware and software designed to emulate it. That includes a high-capacity version of HP's Superdome servers and a programming language called Distributed R. South Korean chipmaker **SK Hynix** has signed a deal with HP to manufacture its memristors when the design is complete. (Fink says he's discussing timing for a "test vehicle.") But HP has been hyping memristors for years without managing to produce them en masse, says IDC's Del Prete. "It's not just demonstrating that a memristor works but that a memristor will be manufactured," he says. "I'm not aware of anybody with

this aggressive of a time frame."

The researchers developing the Machine recognize they have one shot at it, says Rich Friedrich, HP Labs' director for the Machine's systems software. "We can't afford either in time or in dollars or in engineering costs, once we evolve something, to throw everything out and start again," he says. Whether one company or two, HP also needs to think about the reputational costs of failure, says Jim Handy, an analyst with researcher Objective Analysis. There's a reason no other company has been so public about trying to do all the things a project like the Machine requires at the same time. Handy says: "If any one component is missing, then it's as good as not having any of them." —*Jack Clark*

The bottom line With HP's split fast approaching, its engineers are figuring out how to keep working together on its biggest project.

E-Commerce

Japan's Amazon Has Bigger Dreams

▶ Hiroshi Mikitani's Internet giant spends billions on deals abroad

▶ "We cannot just stay in Japan and try to protect our turf"

In Japan, there's no escaping **Rakuten**. Since its 1997 founding, the shopping-website operator has become much more than an **Amazon.com** look-alike—it's expanded into sports, financial services, even family planning. When

Rakuten's pro baseball or soccer teams win a game, the 90 million members of the company's loyalty program, including its 11 million credit card users, get extra points for purchases on its primary online marketplace, Ichiba. They also get points for using a Rakuten Bank debit card, signing up for Rakuten Broadband, booking a salon through Rakuten Beauty, hiring a mechanic through the company's vehicle inspection service, or buying a policy from Rakuten Insurance. Couples can plan their nuptials through Rakuten Wedding, or use the Rakuten smartphone app Beauty°C Navigator to predict the best time to try and conceive a child, based on the would-be mother's body temperature.

Partly as a result of this diversification, one in four online purchases in Japan takes place on Ichiba—impressive even by the standards of **Alibaba's** Taobao in China. "We invented this marketplace model, and our international competitors basically followed," says Hiroshi Mikitani, Rakuten's founder and chief executive officer.

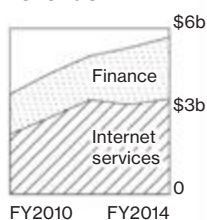
Outside Japan, however, Rakuten barely rates. It's almost unknown in the U.S. and Europe, where Amazon rules, and Alibaba had already outpaced it in China well before Mikitani's partnership with **Baidu**, China's Google, collapsed in 2012. Rakuten's limited footprint is a serious problem given Japan's declining population and lackluster economy. So Mikitani, like many Japanese CEOs, is increasing efforts to expand abroad, buying foreign startups and investing in others.

On March 19, Rakuten announced the \$410 million purchase of **OverDrive**, a Cleveland e-books distributor. That

purchase came only a week after Rakuten led a \$530 million round of funding for Uber rival **Lyft**, spending \$300 million for a 12 percent stake in the car-service app. In September the company spent \$1 billion to buy **Ebates**, an online coupon service in San Francisco, and earlier in 2014 it bought the Cyprus-based messaging app **Viber** for \$905 million. Rakuten now offers a credit card in the U.S. through a partnership with a subsidiary of **First National Bank of Omaha**. “The Internet is a global business,” says Mikitani, a Harvard MBA who made English the official language of Rakuten in 2011. He wants to assemble enough properties to put Rakuten on the map in the U.S. and Europe. “We cannot just stay in Japan and try to protect our turf,” he says.

All told, Rakuten has spent at least \$2.6 billion on deals abroad since the start of 2014, data compiled by Bloomberg show, although Mikitani has mostly focused on scooping up also-rans at relative bargain prices. Viber

Rakuten revenue



has 236 million monthly users—well shy of WhatsApp’s more than 700 million, but ahead of **Line**, Japan’s leading messaging app. In February 2014, Rakuten paid less than 5 percent of the \$19 billion that Facebook spent to buy WhatsApp five days later. “Viber makes Rakuten instantly global,” says Talmon Marco, the app’s founder. Marco says he initially met with Mikitani in early 2014 to discuss an investment, but the Japanese billionaire persuaded him to sell. “He wasn’t the uptight business guy that you get to meet a lot. He wasn’t a weird geek,” says Marco. He “was a person you can actually talk to.”

In some cases, Rakuten has been able to make money from its rivals. Consumers who sign up for Ebates can use the website to browse the selections of other e-commerce sites, including Amazon, and get cash back on their purchases; Ebates gets a small commission. The discount service made about \$20 million in operating profit last year on \$5 billion in transactions, estimates Masaru Sugiyama, an analyst in Tokyo with Goldman Sachs. It could become the foundation for a strong U.S. business

by encouraging customers to use Rakuten’s U.S. marketplace and credit card, he says. “This could turn into a proper e-commerce platform” abroad, Sugiyama says. “They can finally start to build on this.”

Rakuten has had trouble making many of its other acquisitions profitable over the past few years, particularly the Kindle wannabe Kobo, which it bought for \$315 million in 2011. Based in Toronto, Kobo has yet to turn a profit. But it had 23 million users at the end of 2014, a 25 percent increase from the previous year, and cut losses by discontinuing some of its lackluster hardware lines to focus on selling e-books through a mobile app. Although Rakuten’s noncore Internet businesses—meaning properties like Kobo but not Ichiba—lost \$12.5 million in the last three months of 2014, that’s a lot better than the \$108 million they lost in the same period the year before. Companywide operating profit jumped 73 percent in the fourth quarter, and the stock price has risen 93 percent over the past six months, hitting a 52-week high on April 8. “This is a big improvement,” says Keiichi Yoneshima, a director with Barclays in Tokyo.

It’s still early in Rakuten’s attempts to expand its business around the globe, and there are risks to Mikitani’s strategy. Its recent e-books purchase probably won’t do much to boost Kobo sales. Viber doesn’t have the numbers of WhatsApp or the heat of messaging apps like **Snatchat**. And Rakuten may not have the cash to go toe-to-toe with big U.S. Internet leaders. The company notched \$5 billion in revenue last year; Amazon took in \$89 billion. Lyft’s

March funding boosted its valuation to \$2.5 billion,

but Uber is worth more than 16 times as much. Amazon declined to comment.

Mikitani says a dominant market share isn’t the only measure of success in a global business. “This is very different from a winner-take-all environment,” he says. “Consumer behavior tells us there is room for several players on the screens of smartphones.” For now, he says, he’s focused on linking his recent investments together. Mikitani wants to turn Viber into a mini-app store, selling games, e-books, music, and video, and hopes to use Lyft drivers to deliver Rakuten purchases. “You need to always have several alternatives,” he says. —Bruce Einhorn

The bottom line Rakuten has spent at least \$2.6 billion since the start of 2014 to expand abroad but has little to show for it so far.

Delivery

Drone Makers Seek Traffic Control

▶ **NASA-backed software could orchestrate urban skies**

▶ **The “question our system has to answer is, ‘Where is it safe to fly?’”**

The commercial use of drones remains mostly illegal in the U.S. All the same, businesses are moving ahead with ways to profit from the small helicopters, with some assistance from the Federal Aviation Administration. In February the FAA, which is preparing drone rules, agreed to exempt **State Farm** from the prohibition, letting the insurer test the use of drones ▶

Quoted

“I wanted a bit of a change... felt it was time for me to find my next chapter as part of a smaller partnership.”

Matt Murphy, the Kleiner Perkins Caufield & Byers partner who fired Ellen Pao, talking about his departure from the venture firm in the *Wall Street Journal* on April 6

Pao lost her gender discrimination suit against Kleiner on March 27

Review

Apple Watch

The company has made the world's best smartwatch, but it hasn't made the case that you need one

I'm in a meeting with 14 other people when I feel a tap-tap-tap on my wrist. I stop talking in midsentence, tilt my head, and whip my arm aggressively into view. The motion triggers the screen on my Apple Watch to life with a very important message: Twitter has suggestions for people I should follow. A version of this happens dozens of times throughout the day—for messages, e-mails, tweets, fitness achievements, and so much more. Wait a second: Isn't the promise of the Apple Watch to help me stay in the moment, focused on the people around me, and undisturbed by the mesmerizing void of my iPhone? Why do I suddenly feel so distracted?

Let's back up. The watch is Apple's first new product since the death of Steve Jobs, created almost wholly under the guidance of Jobs's successor, Tim Cook. It's Apple's first device developed entirely—hardware and software—by design guru Jony Ive. With prices starting at \$349 and climbing much higher than \$10,000, Apple has positioned its smartwatch as both the latest must-have gadget and a bona fide luxury item. To say it's a major moment for the company would be an understatement.

No one's questioning the ability of a company with \$178 billion in cash to make money. But with the watch, Apple faces two challenges. First, it has to make a beautiful gadget that hews to its history of groundbreaking design and technological innovation. Second, Apple has to convince people they need the thing on their wrist. There are already plenty of wearable gadgets on the market, and none have managed to clear that second hurdle.

The watch's hardware is beautiful, in a surgical way. The little cube of metal

Alerts Notifications can be customized so different levels of vibration signal different things.

and glass wouldn't seem out of place in a futuristic lab or sci-fi movie. As a piece of jewelry, however, it's similar to other digital watches, including Casio's iconic calculator watch, and other smartwatches, such as the Asus ZenWatch and the Samsung Gear Live. Apple's design doesn't compete with Rolex, Omega, or Breitling. Still, the more I wore the inconspicuous thing, the more comfortable I felt with it.

The Apple Watch is the most advanced piece of wearable technology you can buy today. The tiny screen is pressure-sensitive, responding differently to lighter and heavier taps. Vibrating notifications that produce a striking bell-tapping feeling on your wrist can be customized so different levels of vibration signal different things. A crown on the watch's side works like the old iPod wheel, helping to navigate long menus and zoom in and out of maps and photos with surprising precision. Its timekeeping is within 50 milliseconds of the global time standard, and you can

Isn't the promise of the Apple Watch to help me stay in the moment...undisturbed by the mesmerizing void of my iPhone?

Fitness Awareness of my activity levels paid off almost immediately: I wanted to walk more, was excited when I had a brisk jog through a train station, and, yes, felt better because I stood up on a regular basis.

add widgets at the edge of the display that show the temperature, your next calendar appointment, phases of the moon, and so on.

As a simple timepiece, though, the Apple Watch can be frustrating. You can't rely on a quick glance to tell you the time. To activate the screen, you have to tap it or forcefully swing your wrist upward. Think about the way a person normally looks at his watch—

then make it look twice as nuts.

The watch also isn't ideal when it comes to extending or replicating the functions of your phone. It can receive and send text messages, but that's tough if you're working on more than a one-line reply. The system of knobs and taps takes some getting used to as

well, so it can be tempting to pull out your phone instead.

Apple sends a push notification that pings the watch every time you get a work e-mail, personal e-mail, direct message on Twitter, message on Facebook, etc. To make the system useful, I had to prune a list of VIP contacts in my e-mail app and carefully choose which apps seemed vital, then turn off notifications from the rest. Still, checking texts and e-mails by quickly glancing at the watch did save me time and was helpful when I was engaged in something more important. My

Checking time To activate the screen, you have to tap it or forcefully swing your wrist upward. Think about the way a person normally looks at his watch—then make it look twice as nuts.



By Joshua Topolsky

14-month-old daughter, who's obsessed with the iPhones in our house, didn't seem to notice that I was getting an update on my wrist.

Less useful are the watch's little messaging apps, which let you send animated emojis, drawings you've tapped on the watch face, or samples of your heartbeat. In each case, the novelty wears off quickly. A feature called Glances can give you a peek at information from your apps, such as the latest tweet in your timeline; but because it has to pull information from the phone in your pocket, it often leaves you waiting on a spinning wheel instead of giving you a quick update.

The built-in health app, Activity, is more impressive. It distinguishes between basic movement, more strenuous exercise that boosts your heart rate, and simple standing (to make

sure you get on your feet once an hour). Added awareness of my activity levels paid off almost immediately: I wanted to walk more,

was excited when I had a brisk jog through a train station, and, yes, felt better because I stood up on a regular basis. This may not have any lasting impact on my health, but Apple's quick primer on exercise habits is a leap in the right direction.

The Apple Watch is more seamless and simple than any of its counterparts. It is without question the best smartwatch in the world, an excellent addition to the company's carefully built ecosystem. Analysts' sales predictions for 2015 range from 8 million to 41 million, in the same ballpark as the iPad's first year, and the watch is good enough that it could hit those numbers. It speaks well of the company's broader ambitions, including a possible entry into the auto market.

I'm not convinced, though, that I need an Apple Watch. Its insistent vibrations can be more distracting than your iPhone, the struggle to activate the screen makes it impossible to check discreetly, and it's still another screen. The watch is cool, it's beautiful, it's powerful, and it's easy to use. But it's not essential. Not yet.

Texting It can receive and send text messages, but that's tough if you're working on more than a one-line reply.

◀ in claim inspections.

On March 19 the agency granted **Amazon.com** a waiver to continue testing its package-delivery drones. And in Portland, Ore., startup **SkyWard** is pushing forward with a drone traffic control system that will allow thousands of the machines to fly through cities without colliding with one another or endangering people.

SkyWard is working with NASA and the world's three largest drone makers—**DJI** in China, **3D Robotics** in the U.S., and **Parrot** in France—to demonstrate that swarms of drones can safely coexist in crowded airspace. “It’s about applying the regulatory framework to a new kind of aviation infrastructure,” says co-founder and Chief Executive Officer Jonathan Evans. The software project, Urban SkyWays, is designed to resemble a conventional air traffic control system at altitudes of 1,200 feet or lower, says Parimal Kopardekar, who manages NASA’s experiments on drone coordination and whose researchers are contributing their time to the project.

Urban SkyWays would load SkyWard’s cloud software onto each drone and the computer used by its pilot, says Marcos Osorno, SkyWard’s chief technology officer. The software plots the paths of all drones equipped with it, so a dispatcher working for a company such as Amazon or UPS could log on to the system to file a flight plan and receive an automatically generated route, from pickup point to destination, to help a drone avoid other machines. The flight plans will also take into account local and federal regulations. “The first question our system has to answer is, ‘Where is it safe to fly?’” Osorno says.

At this point, not very many places, and not very far. If adopted, the FAA’s rules for commercial drones will restrict flights to their operators’ line of sight. They would also ban flights above unprotected bystanders. Although the FAA acknowledges that technological advances may persuade it to tweak or rewrite the draft rules, slated to take effect in the next year or so, there are no guarantees.

Evans says his work as a helicopter pilot left him confident that drones can operate safely in cities. “I flew in the low airspace in

“There are rules of the road up there, and SkyWard is extending them to drones.”
—SkyWard CEO Jonathan Evans

urban areas all the time,” he says. “There are rules of the road up there, and SkyWard is extending them to drones.” Evans and Osorno met while flying U.S. Army helicopters in Germany more than a decade ago. Evans later flew medical choppers in

Anchorage and Portland.

SkyWard and its partners plan to make money from annual subscriptions paid by drone operators to use the traffic control software. For now, SkyWard is consulting and working with companies on drone-pilot training and compliance with FAA regulations. In July the 12-employee company received \$1.5 million in venture funding from **Voyager Capital**, **Draper Associates**, and Toivo Annus, the former engineering chief at Skype. It declined to disclose revenue.

Exelis, a major U.S. defense contractor, will unveil a drone-focused companion to its manned aircraft tracking system this month, according to program manager Christian Ramsey. The SkyWard engineers say their expertise in low airspace and the participation of the three leading drone makers give them an edge. Besides, Evans says, drone traffic control is more akin to

managing “flying cell phones” than Boeing 747s.

SkyWard and its partners are planning demonstrations of their traffic control software from May through September in London, Vancouver, Las

Vegas, and Portland. Osorno and Evans say they’re spending most of their time working out demo routines that will be duly impressive—and safe.

3D Robotics has raised \$110 million to bring commercial drones to the mainstream. “Doing it safely and responsibly is a big part of that,” says CEO Chris Anderson. “We’re very much counting on SkyWard to ensure the way.”

—Michael Belfiore

The bottom line Commercial drones are still mostly illegal in the U.S., but the industry and NASA are working to keep them from colliding.

1,200_{ft}

The maximum altitude for SkyWard’s drone traffic control



Bob in accounting is going to fix currency rates



I'll tell Jamie Dimon

► **JPMorgan tests an algorithm to identify potential rule breakers before they stray**

► **“Do people get a scarlet letter for something they have yet to do?”**

In the 2002 sci-fi movie *Minority Report*, Tom Cruise plays a Precrime officer who hunts down murder suspects before they act. Now, after racking up more than \$36 billion in legal bills since the financial crisis, **JPMorgan Chase** is testing an algorithm designed to catch employees before they misbehave as part of an effort to improve culture and controls, says Sally Dewar, who's overseeing the project.

Computers will analyze dozens of factors, including whether workers skip compliance classes, violate rules governing personal trading, or breach market-risk limits, to determine who may be likely to violate government regulations or company policy. Billions of e-mails flow through each bank annually, overwhelming people's

ability to monitor them. “It's very difficult for a business head to take what could be hundreds of data points and start to draw any themes about a particular desk or trader,” says Dewar, head of regulatory affairs for Europe. “The idea is to refine those data points to help predict patterns of behavior.”

The surveillance program, which JPMorgan is testing in its trading business and will deploy throughout its investment bank and asset management division by 2016, offers a glimpse into Wall Street's future. Reeling from billions of dollars in fines after employees rigged markets, cheated clients, and aided criminals, the industry is under pressure to police itself better. Failure to do so would provide ammunition to those pushing for a return to laws that

would require trading operations to be separated from deposit-taking banks.

JPMorgan, which remained profitable during the financial crisis, has been subject to government probes into its mortgage bond sales, a \$6.2 billion trading loss, services it provided to Ponzi scheme operator Bernard Madoff, and the rigging of currency and energy markets.

E-mails, chats, and telephone transcripts can be analyzed electronically to determine if employees are trying to collude or conceal intentions, says Tim Estes, chief executive officer of **Digital Reasoning Systems**, which works with Goldman Sachs and Credit Suisse, but not JPMorgan. “We're taking technology that was built for counterterrorism and using it against

The bank has spent \$730 million on compliance operations over the past three years

A bank in London tries something new: Pleasing customers 36

Bid/Ask: FedEx beefs up in Europe; streaming *Star Wars* 38

Shale drillers cash in on price-plunge insurance 37

human language, because that's where intentions are shown," he says.

The technology raises ethical questions. "What they're trying to do is forecast human behavior," says Mark Williams, a former Federal Reserve bank examiner who's now a lecturer at Boston University Questrom School of Business. "Policing intentions can be a slippery slope. Do people get a scarlet letter for something they have yet to do?"

Dewar, who spent about a decade at the U.K.'s Financial Services Authority before joining JPMorgan in 2011, says the bank will be careful to strike the right balance between its interests and employees' rights. She says thousands of investment banking and asset management employees will be subject to the predictive monitoring, but she won't describe all the information being fed into the program, which specific business it's being tested on, or how it would handle employees the software identifies as potential rule breakers.

A February memo from top executives urged employees to flag compliance concerns to managers and reminded them that scandals hurt bonuses for everyone. The bank created dedicated whistle-blower phone lines and e-mail addresses for workers to raise issues anonymously. "The problem we saw last year in FX and the other unacceptable events have implications beyond just a one-time fine," according to the memo.

"They damage our reputation." FX refers to currency trading.

New technology is half of a two-pronged effort to reduce regulatory and legal bills at JPMorgan. The other part involves a review

of the company's culture, Dewar says. The bank designated more than 300 executives in the investment bank to be "cultural ambassadors" who focus on standards. A report titled "How We Do Business," published on the bank's website in December and signed by CEO Jamie Dimon, outlines ways

JPMorgan is improving compliance, including starting a global communications surveillance program. It says the bank has spent \$730 million on compliance operations over the past three years, which includes the hiring of 2,500 workers. "We recognized that enhancing market conduct would require using multiple preventive and detective levers in a coordinated way," the report says.

JPMorgan's financial targets rely on reducing legal bills. The investment bank's return on equity will rise to 13 percent from last year's 10 percent largely by cutting legal and other expenses, according to a February investor presentation. Dewar acknowledges that even a sophisticated computer program can't anticipate all the ways humans can break the rules. "We'll have a much greater confidence level about early detection," she says. "I don't think you could ever say it will be 100 percent." —*Hugh Son*

The bottom line JPMorgan will look at employee e-mails and other data to identify potential misbehavior and reduce legal bills.

Real Estate

Harry Potter Makes Foreclosures Disappear

► A tourism and hiring boom boosts home sales in Orlando

► "The good things happening lift my spirits"

The empty, foreclosed homes that plagued Orlando's Pine Hills neighborhood—also known as Crime Hills—are coming back to life. A family of seven moved into the vacant property next door to Sam Braunn, a 63-year-old who has lived in the neighborhood since junior high school; and the house on the other side of his was renovated with a new columned facade. "I'm seeing more and more homes vacant for a long time filling up," says Braunn, a construction union employee based at Walt Disney's parks. "The good things happening lift my spirits about getting my place back

in shape. I've been trimming up the bushes and removing the extra lumber that was lying around."

Pine Hills can thank Harry Potter—and the Florida legal system. Tourists flocking to Orlando's ever-expanding theme parks have pumped money into the local economy, and the courts have cleared up a backlog of foreclosure cases, allowing more homes to be sold. Florida legislators set aside more than \$16 million in 2013 to hire retired judges and case managers to handle foreclosures. After peaking

at about 30,000 in 2011, pending cases in Orange County's courts were down to 4,930 at the end of March, says Lisa Munyon, a circuit judge.

Rather than causing a glut, the new supply is spurring purchases in a market starved for affordable listings. Existing-home sales in the Orlando metropolitan area jumped 19 percent in February from a year earlier, setting a record for that month. Bulk purchases of foreclosed homes by private equity firms such as **Blackstone Group** in recent years helped put a floor under the market. The firms pulled back as prices rose, and now first-time buyers and individual investors from the U.S., Brazil, Canada, and China are doing the buying. Foreclosures made up about 29 percent of sales in February and 34 percent in January, the two highest levels since 2011, according to the Orlando Regional Realtor Association. "Our sales have increased from where they were with the institutional buyers, and not only because of the interest of owner occupants but because there is more inventory for sale," says Mercedes Henriksson, Florida foreclosure sales director for Fannie Mae.

Christian Marin, an agent with Altura Investment Realty, says most of his buyers are investors who see job growth in the area creating more reliable rental tenants than they had a few years ago. He credits the theme parks less than 30 minutes away. "The economy is doing good," he says, adding that Altura sold about 100 foreclosed houses to investors last year. "People want to take a vacation, ►

"The weakness of our economic base is that tourism is highly vulnerable to recession."
—Rick Foglesong, Rollins College

\$36b

JPMorgan's legal bills since the financial crisis

A new 650-acre Medical City complex is expected to employ up to 3,000

Disney drew record crowds in the last three months of 2014

Orlando magic

19%

Increase in existing home sales in February

Employment at Universal Studios has grown by 7,000 since 2009, to 20,000

29%

Portion of February home sales that were foreclosures

19%

Rise in the median sales price of bank-owned homes in Central Florida in February from the previous year

◀ and they're all coming here."

Universal Orlando Resort, owned by Comcast, sparked a rebound in tourism jobs with the opening of the Wizarding World of Harry Potter-Hogsmeade in its Islands of Adventure park in 2010. Last year a replica of the movie's Hogwarts Express steam train began carrying visitors to and from the neighboring **Universal Studios Florida**, where a new Harry Potter-themed area called Diagon Alley has replaced the Jaws attraction, which opened in 1990. Employment at Universal Orlando has jumped to 20,000, from 13,000 in 2009.

Walt Disney, which saw record attendance at its U.S. theme parks in the fourth quarter of 2014 with a 7 percent jump from a year earlier, finished doubling the size of Fantasyland last year, the biggest expansion in the Magic Kingdom's 43-year history. **Walt Disney World Resort** includes four parks and is the region's largest employer with 74,000 workers.

Orlando-area employment was up 4.2 percent in February, and the unemployment rate fell to 5.3 percent from 6.3 percent in February 2014. "When Harry Potter was a hit, the other theme parks all benefited," says Anthony Crocco, Central Florida director for new home construction tracker Metrostudy. "It's helped Orlando come out of the housing doldrums faster than other markets."

Homebuilders are also getting a lift from the tourism boom. **Meritage Homes'** Central Florida net income doubled in the past two years, with "explosive growth" in places close to the theme parks, says Clint Szubinski, the company's regional president. Meritage has held two lotteries over the past two years for separate groups of 40 lots at the Parkside community in the affluent Dr. Phillips neighborhood near the entrance to the Universal theme parks. Each lottery drew more than 300 buyers applying for a chance

to buy houses that now sell for an average of \$753,000, Szubinski says.

Although tourism has helped the area recover, it's not the ideal foundation for an economy, says Rick Foglesong, a professor of politics and urban planning at Rollins College in Winter Park, Fla. "The weakness of our economic base is that tourism is highly vulnerable to recession," he says. "It's good to have someone hiring. I would not call Disney exploitative of its workforce. It's just not the kind of job you want in order to generate genuine economic development with good jobs at high wages." —Prashant Gopal

The bottom line Orlando's existing-home sales rose 19 percent in February, with foreclosures accounting for 29 percent of the total.

Financial Services

Building the 'Apple of Banking' in London

▶ **Vernon Hill challenges the establishment with better service**

▶ **"The Brits, with good reason, hate their banks"**

Vernon Hill moved to London from the U.S. to open the U.K.'s first new consumer bank in more than a century because he saw an opportunity to shake things up. "The Brits, with good reason, hate their banks more

than the Americans do," he says. At **Metro Bank's** 33 branches, all in and around London, customers can open accounts in 15 minutes, access safe deposit boxes seven days a week, 362 days a year, and have their coins counted for free. "You could call us the extreme example of service and convenience," Hill says. "Nobody buys an iPhone 6 because it's cheap. They're buying it for the whole Apple experience. That's pretty much what our model is."

Metro is among a group of so-called challenger banks taking on **Lloyds, HSBC, Barclays, and Royal Bank of Scotland**, which control about 80 percent of the British market. Lloyds, the leader, has more than 2,000 branches. Metro Bank will open 10 branches this year on the way to a planned 150 by 2020. Hill says he cut the target from 200 because each branch has been taking in more deposits than anticipated.

The five-year-old bank more than doubled deposits in 2014, to £2.9 billion (\$4.3 billion), from the year before. The long-term goal is at least £50 billion, which would represent about 5 percent of the market in southeastern England. Although the bank lost £38.8 million last year, Hill says it aims to make its first profit next year. Revenue grew to £31.5 million in 2013, from £11 million the previous year, according to the most recent figures available.

Hill made his fortune from Commerce Bancorp, the New Jersey-based bank he started with one

Metro Bank

Founded in 2010, the U.K.'s first new consumer bank in more than 100 years has 33 branches

Customer service

- ▶ Branches open seven days a week
- ▶ Free coin counting
- ▶ Dog treats



Chairman Hill

Deposits

£2.9b

▲118% from 2013

2014 loss

£38.8m

outlet in 1973. He was replaced as Commerce Bank's chief executive officer in June 2007 after regulators forced Commerce to stop doing business with companies controlled by his family. Commerce Bank had previously disclosed in regulatory filings that it paid a firm owned by Hill's wife, Shirley, \$50 million over a 10-year period to design and furnish branches. Commerce Bank also leased land and space from partnerships that included Hill and a Hill family trust. In October 2007, Toronto-Dominion Bank, parent of TD Bank, bought Commerce Bank for \$8.5 billion.

In the U.K., Hill has hired his wife's company in an arrangement similar to the one at Commerce Bank. Metro Bank pays **InterArch**, a firm she owns, for services including architectural design, construction management, and signage, according to a company filing. "She and her team are the brand creators, the building creators," Hill says. Shirley Hill didn't respond to a message left for her at InterArch's New Jersey office.

Hill says U.K. regulators would have denied his banking license if there had been wrongdoing at Commerce Bank, adding that neither investors nor British regulators raised concerns about the arrangement with his wife. At Commerce, "I left because I got tired of being CEO, to tell the truth," Hill says. "The bank got sold. I was never accused of anything."

Ninety-five percent of Metro Bank's shareholders are wealthy Americans—including financier Ken Moelis, investor Steven Cohen, developer Richard LeFrak, and homebuilders Robert and Bruce Toll—and institutions such as **Fidelity Management & Research**, Hill says. "He's done it before, and we thought he could do it again," Bruce Toll says. "London and England are underbanked, in our opinion."

No shareholder is allowed to own more than 10 percent of the company, says Hill, who has a 9 percent stake. **Willett Advisors**, which manages money for Michael Bloomberg, founder of Bloomberg LP, the parent of *Bloomberg Businessweek*, has a passive interest in Metro Bank. "He was successful with Commerce, although he was controversial, but the original investors in the bank did very, very well," LeFrak says, adding that most U.K. bank branches "look like off-track betting parlors."

In interviews with the British press, Hill had discussed plans for an initial public offering in 2012 and again in 2014. He now says one will take place in 2016—the "next time we need to raise capital." He says he won't use the IPO to sell his own shares and he wouldn't consider merging Metro Bank with a competitor. "We're not merging with anybody," he says. "Maybe when I'm dead they'll sell my shares, but not till then." —*Richard Partington*

The bottom line With branches open seven days a week, Metro Bank has drawn \$4.3 billion in deposits and aims for \$74 billion.

Commodities

For Drillers, Low Prices Have a \$26 Billion Upside



► Banks sold contracts that insured shale producers against a crash

► "You don't buy it hoping the house burns down"

Shale drillers didn't count on prices staying high forever. While oil traded for more than \$90 a barrel last year, many bought insurance against a crash. Now that prices have plunged more than 50 percent in less than a

year, drillers have started to collect. They netted at least \$2.4 billion from hedges in the fourth quarter of last year, according to data compiled by Bloomberg, and they stand to collect as much as \$26 billion if crude stays depressed.

The insurance—in the form of derivatives contracts—was sold by the same Wall Street banks that financed the biggest energy boom in U.S. history, including **Bank of America**, **Citigroup**, **JPMorgan Chase**, and **Wells Fargo**. Wall Street passed on the risk to hedge funds, airlines, oil refiners, and utilities. "The folks who were willing to sell it were left holding the bag when prices moved," says John Kilduff, partner at **Again Capital**, an energy hedge fund.

The swift decline in U.S. oil prices—to below \$50 a barrel from more than \$107 in June—caught the industry by surprise. Harold Hamm, the billionaire founder of **Continental Resources**, cashed out his company's protection in October, betting on a rebound. Instead, crude kept falling.

Because there are no rules requiring disclosure of all transactions, it's impossible to identify who will ultimately lose money on the trades. More than a dozen energy companies say they buy hedges from their lenders, including Bank of America, Citigroup, JPMorgan, and Wells Fargo. Danielle Romero-Apsilos, a Citigroup spokeswoman, says the bank actively hedges and manages its risk. Representatives from the other banks declined to comment.

Several drillers do report the names of their counterparties, offering a glimpse of how

Quoted

"Our intention would be to be conservative. I think there are strong arguments for being a little on the late side."

New York Federal Reserve President **William Dudley** discussing the timing of a Fed rate increase

Bid/Ask

By Kyle Stock



\$4.8b

FedEx purchases TNT Express. The acquisition of the struggling Dutch delivery company would give FedEx additional vehicles, staff, and customers in Europe to challenge DHL and UPS. TNT handles about 12 percent of the region's express deliveries and has trucks zipping around 40 European nations. UPS abandoned a bid for TNT in 2013 over antitrust concerns.



\$70b

Royal Dutch Shell swallows BG Group. The deal creates the world's largest producer of liquefied natural gas and may signal the start of a merger spree in the industry.

\$28.9b

Mylan bids for another drugmaker. The generic drug specialist offered to buy Dublin-based Perrigo, which focuses on the U.S., the U.K., Mexico, and Australia.

\$5.3b

Informatica goes private. The enterprise software company was bought by private equity firm Permira and the Canada Pension Plan Investment Board.

\$1.8b

Ventas buys Ardent Medical Services. Ventas, a health-care real estate investment trust, is also spinning off most of its skilled-nursing facilities.

\$560m

Berkshire Hathaway adds an industrial stake. Warren Buffett's company acquired a 9 percent stake in Axalta Coating Systems from Carlyle Group.

\$235m

Vivendi clicks on Dailymotion. The French company is in exclusive talks to purchase the video-sharing site from its owner, Orange, the telecommunications giant.

\$100



Star Wars goes digital. Walt Disney and 20th Century Fox finally worked out an agreement to sell all six space sagas via streaming platforms, such as Amazon.com and iTunes.

◀ the risk of falling oil prices moved through the financial system. That is how some of JPMorgan's transactions are visible. At the end of 2014, the bank owed \$671.5 million to five energy companies, including **Pioneer Natural Resources, Concho Resources, Antero Resources, and PDC Energy**, as those companies' records show. That's the amount the bank would have paid if the contracts were settled on Dec. 31, not including any offsetting trades the bank had made.

It's a similar story for Wells Fargo, which was on the hook for \$460.9 million worth of oil and natural gas derivatives for **Carrizo Oil & Gas, Antero, Concho, Pioneer, and PDC**, according to regulatory filings.

Even big losses on energy trades would not threaten the banks' stability. Commodities are generally a smaller part of their business than lending and underwriting. At the end of last year, JPMorgan had net liabilities of \$2.3 billion in commodity derivatives, not including physical assets and cash from settled trades, regulatory records show, compared with total assets of \$2.57 trillion. Wells Fargo's net commodities liability was \$241 million, according to filings. The bank has total assets of \$1.69 trillion.

The question is whether the banks were able to adequately offset their risk when the market took a nosedive, says Charles Peabody, an analyst at research firm Portales Partners. "The banks always tell us that they try to lay off the risk," he says. "I know from history and practice that it's great in concept, but it's hard to do in reality."

The protection for drillers won't last forever. Most hedging contracts expire this year, company reports show. Oil companies would rather be losing money on the contracts and selling their oil at high prices, says Again Capital's Kilduff. The Bloomberg Intelligence North America Independent Exploration & Production Index fell almost 40 percent in the 12 months through April 8. "It's like homeowners' insurance," Kilduff says. "You don't buy it hoping the house burns down." —*Asjlynn Loder and Dakin Campbell*

The bottom line With oil prices plunging, shale drillers collected at least \$2.4 billion from hedges in last year's fourth quarter.

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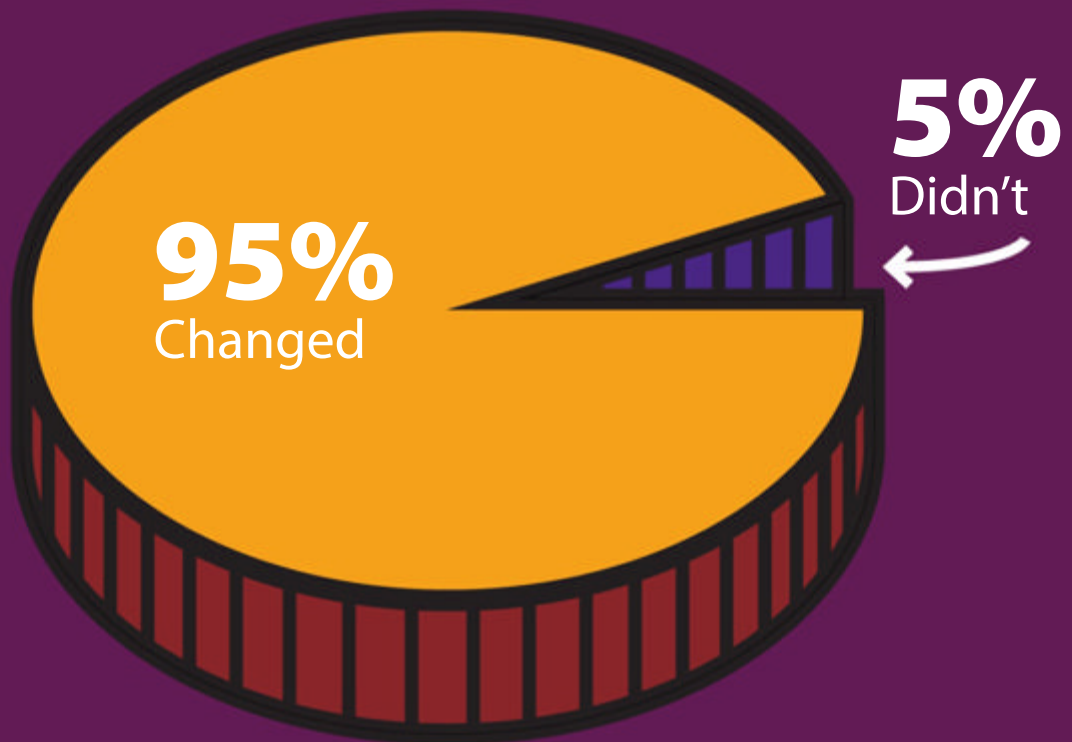
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Wharton's Dean of Happiness

41

► **Elite B-schools are trying to win a place in students' hearts**

► **"They'll write a big check if they had a good experience here"**

Kembrel Jones, dean of student life at the University of Pennsylvania's Wharton School, can describe students' hardships in two words: Champagne problems. "At Wharton, when you get up in the morning and you think you're going to have a bad day, think about why," says Jones, sitting in an office filled with gifts from graduates. There is a framed illustration of Jones's face that a student created by compiling hundreds of tiny photos of members of the class of 2013; a plaque inscribed with a quote from Jones given to him by students graduating this year; and in the center of the room, a one-and-a-half-liter bottle

of Veuve Clicquot, a birthday present from the class of 2014. "Oh, you have an exam? Champagne problems," Kembrel says, pointing to the bottle. "Oh you've got five different interviews today with five different consulting firms? Champagne problems."

That's one of the many lessons Jones imparts to the almost 1,700 students at Wharton. Hired in 2008 to fill the newly created position of dean of students, the Alabama native says he was brought in to lighten things up at the historically serious school. The 55-year-old was recruited to join Wharton from Emory University's Goizueta Business

School, where he was an associate dean in charge of student life. Jones's obsessive focus on students reflects a broader goal among elite graduate business schools to cultivate a place in the hearts—and wallets—of their MBAs, so they'll donate money after they graduate. "To be blunt, they'll write a check, they'll write a big check, if they had a good experience here," Jones says.

Most elite business schools don't have a Jones on staff, but they still devote administrative resources to cultivating loyalty among MBAs. One way they do so is by imitating the close-knit feel of an undergraduate college—a strategy ►

◀ that helps set traditional programs apart from an expanding number of online MBA offerings. At the Yale School of Management, Dean Ted Snyder invites students to his home for meals, where they sometimes meet the alumni relations dean, Joel Getz. “We have in recent years tried to focus more on stu-

dents when they are here,” says Getz. The school recruits a group of students to ask classmates to promise annual gifts to the school about a month before graduation. The group has helped raise \$1.3 million in pledged donations from 770 students since 2012.

Madhav Rajan, the senior associate dean at Stanford’s Graduate School of Business, says part of his job is to give students what they want from the school. In his five years as dean, Stanford has cut down on required courses, added several classes on start-ups, and beefed up faculty to keep class size down, all changes requested by students. In exchange, Rajan isn’t shy about telling students that “we expect them to reciprocate,” he says. The Stanford business school logged \$14.7 million in alumni donations to its business school fund in the fiscal year ended Aug. 31, 2014.

No U.S. business school has been quite as relentless about catering to students as Wharton. Jones has control over nearly all the university’s interactions with students outside the classroom. He was appalled when he noticed that no one was wearing any Wharton-branded gear on campus. “Wharton didn’t give the students any swag that said ‘Wharton’ on it. So it made it look like, well, maybe it’s not cool to go to Wharton,” he says. In his second year on the job he made sure incoming students got umbrellas, T-shirts, and water bottles emblazoned with the school logo.

Jones also created a student committee to run welcome weekends for MBA applicants who’ve been admitted and are visiting campus before making their final decision. The goal is to improve the program’s yield, the share of those admitted who enroll, which has become



an increasingly important measure of a school’s prestige. Wharton’s yield from welcome weekends has climbed to 90 percent in recent years, Jones says, up from around 65 percent in 2010. Getting chosen for the welcome committee is a coveted distinction—250 students applied for the 40 slots in 2014.

Jones in 2009 began hosting soirees for first-years after they’d sat for exams, with beer, wine, and of course, Champagne. Last year he persuaded the school to lease a building in Philadelphia’s Center City, where many Wharton students live, to serve as a lounge, work space, and conference hall exclusively for Wharton students.

In 2011, Jones hired six staffers to help run a new system of so-called clusters, student groups of 200 modeled on Princeton University’s eating clubs, the Ivy League school’s version of fraternities. He says he’s “mesmerized by Princeton,” which has the highest per capita endowment of any U.S. college, and says he pores over the university’s marketing materials for inspiration. At Wharton, MBA candidates also meet with advisers regularly with the aim, Jones says, of making sure “students understand that Wharton cares.”

Total alumni giving has risen steadily since 2008, and after the school put Jones’s face on an e-mail in late 2013 asking for donations, contributions to the annual giving fund increased to \$12.6 million from \$8.8 million the year before. Jones is interested in that upward trajectory, but it’s not what drives him, he says. He’s fervent about his students—he lives near them in Center City and has given his personal cell phone number to 5,000 members of Wharton classes.

Being students’ biggest fan is a job Jones has been preparing for since he was 6 years old. Left out of football games by his more athletic brothers, he realized he could help by encouraging his siblings when they did well and buoying them when they made a mistake. He says he would have been a high school cheerleader if they’d allowed boys to do that in Alabama.

“That’s my job at Wharton,” he says. “I want to thank every one of those boys who are still in my hometown, because without them, I wouldn’t be the highest-paid cheerleader in America.”

—Natalie Kitroeff

The bottom line Donations from Wharton School alumni have increased since the school began focusing on student life.

Admissions

The GRE Puts the GMAT to the Test

▶ The GRE’s administrator wants to tap into the lucrative MBA market

▶ For a business education “the GMAT is still the gold standard”

Once upon a time, the only way for prospective MBAs to have a shot at a business degree was to take the Graduate Management Admission Test, or GMAT. It didn’t matter which business school you wound up in: To get there you had to, among other requirements, pay the test fee to the **Graduate Management Admission Council** (GMAC), which owns the exam, and answer quantitative questions like “If $r \neq 0$, then what is the value of $r/s + s/r$?”

Then, nine years ago, business school applicants around the world started taking the Graduate Record Examinations, a test traditionally used for nonprofessional graduate degree programs—such as a master of arts or international affairs—and administered by the **Educational Testing Service**. From 1954 to 2006, ETS was also under contract to run the GMAT. In 2006, after the contract came up for renewal, GMAC turned the test over to **Pearson**, an educational publisher, and **ACT**, which runs a standardized test for high school students applying to college.

The GMATs had been a lucrative enterprise: News reports at the time said the Pearson-ACT contract was worth \$200 million over seven years. In 2013, GMAC took in about \$80.5 million in test fees from roughly 200,000

124%

Increase in the number of people in India who took the GRE from 2009 to 2013

test takers, according to IRS filings.

After losing the contract, ETS started marketing the GREs, which it has administered since 1949, to business schools as a more flexible, accessible, and less expensive alternative to the GMATs. The GRE costs \$195, compared with the \$250 GMAT. It's offered both as a paper-based exam and on a computer; the GMAT is taken only on a computer. The GRE is appealing to people who want to apply to MBA programs and other graduate programs, says David Payne, vice president and chief operating officer for global education at ETS.

ETS's efforts seem to be paying off: 29 of 30 top U.S. business schools ranked by *Bloomberg Businessweek*, including Harvard, Stanford, and Columbia, now accept the GRE. In 2014 the number of GRE test takers globally rose 3 percent from the year before and 12 percent from five years earlier, according to ETS. The growth is largely attributable to the number of foreign applicants, especially from Asia, hoping to study at U.S. business schools, the test service says. From 2009 to 2013 the number of people taking the exam increased 124 percent in India and 44 percent in China, according to ETS data. "We're seeing massive growth in the middle class in India and China, and more people who have the financial means to support graduate education," says Payne.

The test also is making gains in Europe, where ETS has sent outreach teams to try to persuade more business schools to accept it. According to Christine Betaneli, senior director of public relations at ETS, 92 MBA programs in Europe now accept the GRE.

Still, only 1 in 10 applicants at U.S. business schools submits the GRE instead of the GMAT, according to a survey of U.S. admissions officers conducted by Kaplan Test Prep. The number of GREs administered in the U.S. fell from 445,135 in 2009 to 422,668 in 2013, a drop of 5 percent.

GMAC officials say the market for the GMAT remains strong. "For those who are serious about seeking a business career that starts with a business education, the GMAT is still the gold standard," says Rich D'Amato, vice president for global communications at GMAC.

Business schools aren't pushing one test over the other. "We've said for a while now that not only do we accept

Recruiting Preferred Skills

We asked 1,320 corporate recruiters to name the job skills they value most and to score schools on whether their graduates possess those skills.

—Jonathan Rodkin and Francesca Levy

What Industries Want

What recruiters look for, by sector:

Financial services, banking, accounting

1. Communication skills
2. Analytical thinking
3. Motivation/drive

Consulting

1. Communication skills
2. Analytical thinking
3. Creative problem-solving

Technology

1. Communication skills
2. Ability to work collaboratively
3. Analytical thinking

Consumer Products

1. Leadership skills
2. Ability to work collaboratively
3. Strategic thinking

Health care, medical

1. Communication skills
2. Leadership skills
3. Ability to work collaboratively

Manufacturing

1. Strategic thinking
2. Communication skills
3. Ability to work collaboratively

Pharmaceuticals, biotech

1. Strategic thinking
2. Communication skills
3. Ability to work collaboratively

Retail

1. Communication skills
2. Analytical thinking
3. Strategic thinking

Transportation

1. Analytical thinking
2. Strategic thinking
3. Communication skills

Chemicals

1. Communication skills
2. Leadership skills
3. Analytical thinking

Energy

1. Analytical thinking
2. Communication skills
3. Leadership skills

Business schools send most of their graduates into these fields

Skills Employers Value



| Share of recruiters surveyed who say it's one of the five most important skills | The school that best meets recruiters' expectations for each skill* |
|---|---|
| 1. Communication skills 68% | Stanford |
| 2. Analytical thinking 60% | MIT (Sloan) |
| 3. Ability to work collaboratively 55% | UNC (Kenan-Flagler) |
| 4. Strategic thinking 53% | Harvard |
| 5. Leadership skills 50% | Harvard |
| 6. Creative problem-solving 42% | Stanford |
| 7. Motivation/drive 38% | Virginia (Darden) |
| 8. Adaptability 29% | Virginia (Darden) |
| 9. Quantitative skills 26% | Pennsylvania (Wharton) |
| 10. Decision-making 20% | MIT (Sloan) |

One recruiter said she looks for MBAs who can communicate because it is "nearly impossible" to learn on the job

Wharton has tried to shed its reputation as a quant factory, but recruiters still see it that way

Where Schools Succeed

Top 10 full-time MBA programs as ranked by *Bloomberg Businessweek*

| | |
|------------------------------|--------------------------|
| 1. Duke (Fuqua) | Motivation/drive |
| 2. Pennsylvania (Wharton) | Quantitative skills |
| 3. Chicago (Booth) | Analytical thinking |
| 4. Stanford | Creative problem-solving |
| 5. Columbia | Quantitative skills |
| 6. Yale | Strategic thinking |
| 7. Northwestern (Kellogg) | Creative problem-solving |
| 8. Harvard | Global mindset |
| 9. Michigan (Ross) | Strategic thinking |
| 10. Carnegie Mellon (Tepper) | Analytical thinking |

*For a top skill or school to be listed, it had to be mentioned at least 25 times

Banks are least interested in hiring entrepreneurial thinkers, risk takers, and people with a global mindset

5.7% of those surveyed have lost interest in recruiting at Harvard Business School



◀ both tests, but we are agnostic about our preference,” Dee Leopold, managing director for MBA admissions at Harvard Business School, said last fall.

ETS officials are optimistic about the GRE’s future among budding MBAs. “We’ve been having great success in positioning the GRE for applications to business school programs, particularly MBA programs,” says Payne. The company continues to push its marketing efforts, especially abroad. “The need for advanced degrees is only going to continue to grow,” Payne says, “both in the U.S. and the rest of the world.” —*Akane Otani*

The bottom line The GRE is drawing a growing number of business school prospects in Asia who want to study in the U.S.

Curriculum

Harvard’s Monopoly On the Case Study

▶ The school has cornered the market with a product its rivals use

▶ A case “takes the learner through a reflective and analytic process”

Business schools like to say they’re at the leading edge of corporate innovation, boasting on-campus incubators and electives on design thinking. But almost all rely on a teaching tool that’s barely changed in more than a century. To learn how to lead companies, MBA students read hundreds of case studies—stripped-down narratives about a strategy problem at a real company—and discuss how they would tackle the challenge.

For Harvard Business School, which created and popularized the method—the school taught its first case in 1912—case studies are a cottage industry as well as a bedrock of the curriculum.

Harvard Business Publishing says it sells to about 4,000 schools globally; its cases account for 80 percent of the case studies used.

HBP, which also publishes other business materials, had revenue of \$194 million in 2014, according to

the business school’s annual report, a 44 percent increase from 2010. The publisher, which doesn’t break out revenue from case studies, says it sold 12 million cases last year, to schools, companies, and others. Retail prices run from \$9 to \$15 for a basic case study; schools get discounts. Case sales far outpace sales of HBP’s other books and subscriptions to the *Harvard Business Review*, which it also publishes.

“The case method takes the learner through a reflective and analytic process that is very powerful,” says Robert Bruner, dean of the University of Virginia’s Darden School of Business. Some of Harvard’s case studies seem hardly more sophisticated than Wikipedia entries, and that’s deliberate, says Willis Emmons, director of Harvard’s C. Roland Christensen Center for Teaching and Learning. “Our cases are intentionally very limited in the amount of analysis they include,” he says. “The challenge for the student is to take both qualitative and quantitative information and make sense of that.”

HBP also sells teaching notes for business professors to facilitate class discussion of the cases. These include suggestions for specific words instructors should write on blackboards. At Harvard Business School, professors are given detailed profiles of their students, called class cards, that dictate the order and timing of whom they call on in a typical 80-minute class. “The stronger and more experienced a faculty member is, the less visible it is how much work has gone into a session,” says Emmons.

The sheer scale of Harvard’s publishing machine helps it maintain dominance in the case market.

Darden Business Publishing calls itself the second-biggest publisher of cases in the U.S., but it sold fewer than 700,000 cases in 2014, according to Steve Momper, DBP’s executive director. HBP produces and distributes co-branded case studies for about 40 business schools. These include the University of California at Berkeley’s Haas School of Business, which launched a case series last year. Haas has no designs on challenging Harvard’s market share; the school publishes cases to strengthen its brand and showcase the technology industry expertise of its Bay Area-based staff,

Light Reading

Popular HBP case studies

Starbucks: Delivering Customer Service

The coffee company isn’t meeting customer expectations. How can it increase customer satisfaction without hurting the bottom line?

Sir Alex Ferguson: Managing Manchester United

Rival Manchester City’s new owner is investing

big in new players. How can Man-U’s manager lead the team to another victory?

The Blonde Salad

Fashion blog founder Chiara Ferragni wants to monetize her site, as well as a shoe line. Should the blog and the shoe line be merged, or remain separate?

says Richard Lyons, the dean.

Case publishers often try to add variety to material that, well into the 1970s, featured subjects that were “virtually always male and in settings that were quite prominently in the U.S.,” says Darden’s Bruner, who received an MBA from Harvard Business School in 1974. HBS is trying to reflect a more modern business landscape. In 2014, Nitin Nohria, dean of the business school, pledged to raise the share of women protagonists in Harvard cases to 20 percent. Cases increasingly incorporate video and Web-based elements, and a few find business lessons in unconventional sources, such as the case HBP published last year by Harvard professor Anita Elberse devoted to Beyoncé’s surprise 2013 album release.

Of the 25 top business schools ranked by *Bloomberg Businessweek* last year, 19 reported that they use case studies as one of their main teaching tools. At HBS, 80 percent of class time is spent on case studies; at Darden, the figure is 75 percent.

Carnegie Mellon’s Tepper School of Business uses case studies for about 30 percent of its instruction, according to Dean Robert Dammon. It considers them a supplement to management science, a teaching method developed at Tepper. “The school was really founded to find an alternative approach to business education than the one that was being offered by schools like Harvard,” says Dammon. “In a case study, the relevant set of facts is laid out for you. Most business problems aren’t presented to you in that way.” —*Francesca Levy*

The bottom line The publishing arm of Harvard Business School sells case studies to about 4,000 business schools worldwide.

B Edited by Cristina Lindblad and Dimitra Kessenides
Bloomberg.com



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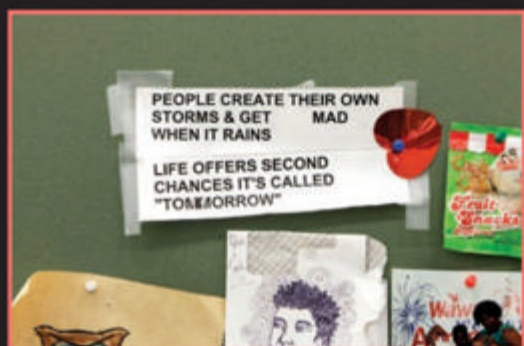
The Taxman Bumm



The IRS's understaffed Taxpayer Assistance Center in Philadelphia has been cutting back services for overwhelmed filers. Below: Candace Gaddy



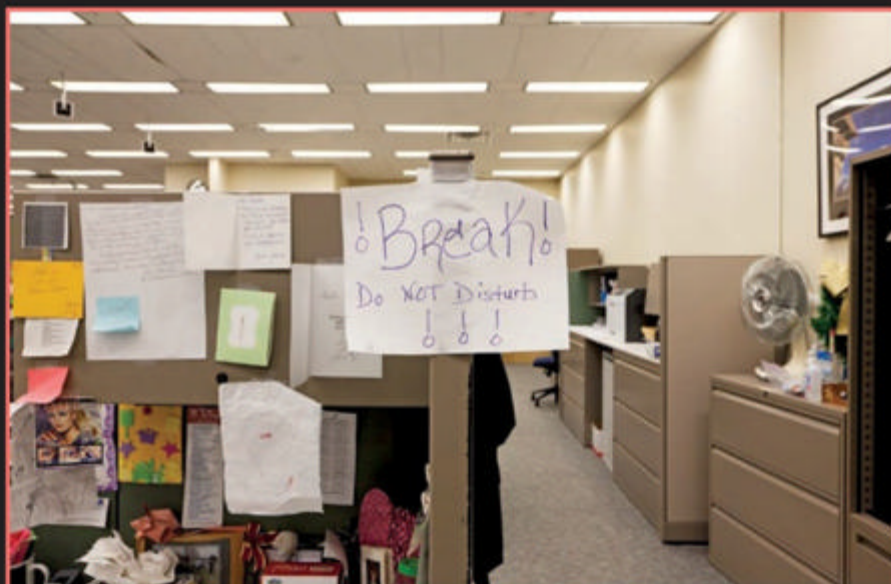
eth



Paying taxes to the
IRS is no fun.
Neither is working there

By
Devin Leonard and
Richard Rubin

Photographs
By Will Steacy



They start lining up before 7 a.m. An hour and a half later, more than 60 people are waiting to get into the Internal Revenue Service's Taxpayer Assistance Center in Philadelphia, across the street from the Liberty Bell. Young men in parkas and Phillies caps lean sullenly against the wall. Older couples camp on the hard marble floor with their forms in their laps. Some have haunted the lobby for several days, waiting to see someone like Candace Gaddy.

Inside the service center, Gaddy, an IRS taxpayer assistance specialist, sits stoically in a beige cubicle marked by an electric sign with a red numeral 5. She has long, dark hair and wears a white turtleneck, black vest, black jeans, and black boots. She's neatly arranged stacks of tax forms on her table in front of her. The speakers of her Hewlett-Packard computer softly emit the Jay Z song *99 Problems*. She'll hear quite a few from taxpayers today.

A 16-year IRS veteran, Gaddy wishes she could share some of her own IRS troubles with her visitors. Her salary has risen only 2 percent in the last four years. The center lost its secretary and hasn't replaced her because of a four-year-old hiring freeze throughout the agency, which means Gaddy and the remaining employees handle clerical duties, too. One of her fellow specialists spends all his time now answering questions via webcam from taxpayers in Harrisburg, Pa., because that office is short-staffed. Last year, to reduce the lines, the IRS discontinued its practice of preparing simple tax returns as a courtesy for people, many of them elderly. But in Philadelphia the queues have stayed the same or grown longer, because so many people come in with questions about tax credits for Obamacare and what to do to prevent identity thieves from stealing their refunds. (Because the refunds come

on ATM-ready debit cards, thieves like to file victims' returns ahead of time, with a different address.) "I mean, we still had lines," Gaddy says, "but not out the door and around the corner."

The IRS has never been an easy place to work. Its 84,000 employees, 65 percent of them women, generally don't tell people outside the service where they draw a paycheck. It's no way to make friends. They toil in purposely anonymous buildings—a big sign outside might attract crazies. In 2010 an antigovernment zealot flew a single-engine plane into a building in Austin, Texas, where 190 agency employees worked, killing one of them. "Well, Mr. Big Brother I.R.S. man, let's try something different, take my pound of flesh and sleep well," the pilot, Joseph Stack III, wrote in a six-page suicide note.

More recently, the IRS has become a casualty of the budget battles between the Obama White House and House Republicans. Since the GOP won control of the chamber in 2010, the agency's annual budget has fallen by \$1.2 billion, to \$10.9 billion, in 2015. Meanwhile, the agency has lost 11 percent of its employees. Last year it started 19 percent fewer criminal investigations than 2013. This year alone, it expects to close at least 46,000 fewer audits. Nobody likes being scrutinized by the IRS, but audits are a key component of the tax system that keeps the U.S. afloat. "It's core to the country," says Jeffery Trinca, a former Senate aide turned lobbyist who specializes in tax policy.

The agency's customer service operation has been hobbled, too. In late March, the IRS said fewer than 40 percent of the people who call during this tax season will get through to someone. A decade ago, the figure was 83 percent. The agency is so short on funds that some employees purchase their own office supplies, even though the IRS says they shouldn't. "I

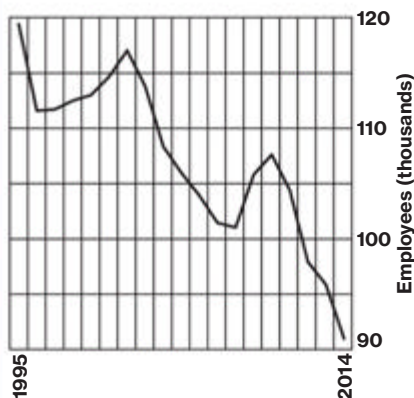
buy my own pens," says Catherine Ficco, a revenue officer in West Nyack, N.Y. "I buy my own clips and hole punchers and things of that nature. It's not uncommon. There's no money to order supplies or paper for my printer."

The IRS has long been disliked, but its employees aren't used to being vilified. In May 2013 the agency disclosed that it had given extra scrutiny to Tea Party groups that were seeking nonprofit status. To Democrats, the decision to group together Tea Party applications and other politically oriented groups was merely a misguided attempt to find a consistent rule after years of muddled policy. "There were some boneheaded decisions," President Obama told Fox News. To Republicans, the IRS's hard look at Tea Party groups proved the service has a political bias. Since then the IRS has been consumed with scandals large and small: an expensively produced internal video that featured top executives dressed as *Star Trek* characters; a lavish conference funded with enforcement money where officials slept in presidential suites, albeit discounted ones; and the rehiring of employees accused of misconduct, including some who hadn't filed their own taxes.

With a presidential election next year, Republicans seem determined to keep the scandals percolating. Texas Senator Ted Cruz may have set the tone in March, announcing his candidacy with a promise to abolish the IRS. He says its agents won't be needed after he throws out the current tax structure and replaces it with a simple flat tax, enabling Americans to fill out their returns on postcards. Cruz wants them reassigned to border patrol duty.

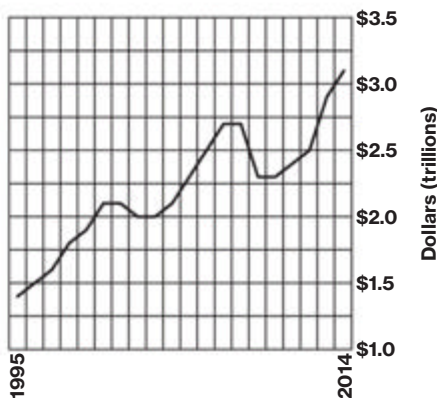
In May 2013, Obama ousted Steven Miller, the acting IRS commissioner, and shortly after named John Koskinen, a former corporate takeover expert, as his replacement. Koskinen has two challenges: restoring the public's confidence

Fig. 1
Size of IRS workforce



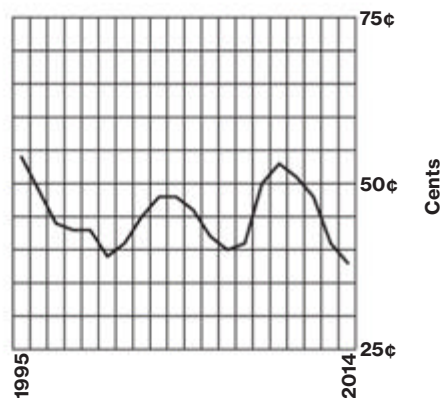
DATA: IRS. INCLUDES SEASONAL WORKERS

Fig. 2
Money collected



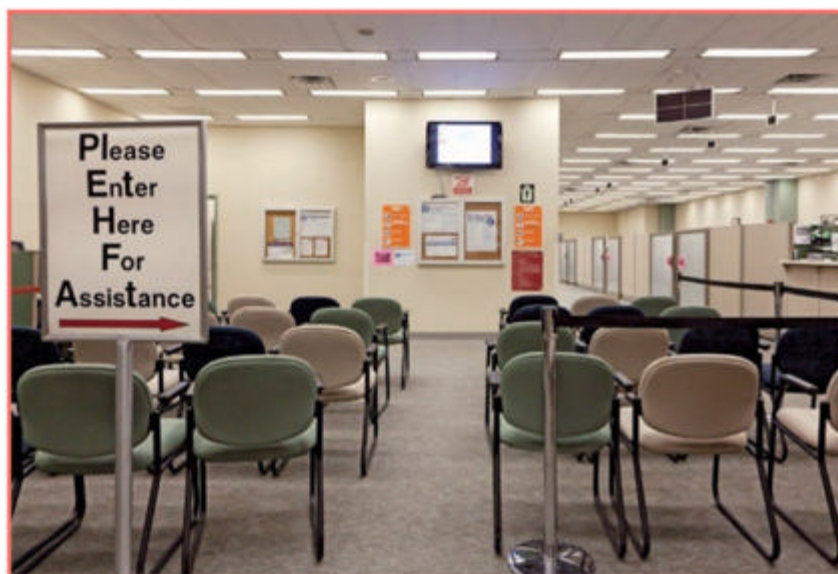
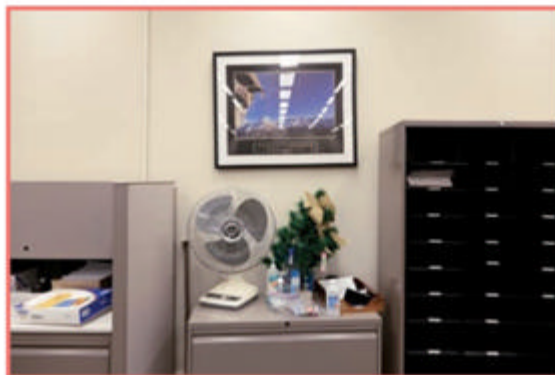
DATA: IRS. AMOUNTS ARE IN CURRENT DOLLARS

Fig. 3
Cost of collecting \$100



DATA: IRS. AMOUNTS ARE IN CURRENT DOLLARS

“I buy my own pens. I buy my own clips and hole punchers and things of that nature. It’s not uncommon”



Budget cuts, hiring freezes, and travel restrictions threaten IRS workers' ability to perform basic job functions

in the service and keeping employees from giving up hope. It may be too late for the latter. IRS veterans say it's fine for Republicans and Democrats to disagree about the level of taxation in America, but they can't do their jobs without functional computers and sufficient supplies. "I still get calls from people that worked for me who talk about the overload they are facing and what's happening to them," says Dorothy Taylor, a former IRS territory manager who was based in Plantation, Fla., before retiring in December 2013. "I try to reassure them that there have always been ups and downs in the organization. I tell them to just keep their heads down and do their job, and hopefully the IRS will pull through like it has in the past. But my concern is, will it?"

People who've spent their careers at the IRS all say the same thing: The pay wasn't fantastic, but the health care and pension benefits were. And they went to the office each morning with a sense of purpose. Without their efforts, they knew, the federal government would stop working.

Whether they worked in Manhattan or Peoria, Ill., IRS veterans talk about something else that kept them at the service: the feeling of camaraderie. It was nice that they appreciated one another, because nobody else did. "You go to a party, and if you say you are from the IRS, half the people move into the other room," says Richard Schickel, a former senior collections officer in Tucson who retired in December 2013. "After a while, your wife and relatives get tired of listening to your stories. They say, 'How could you take those people's houses and their businesses?' The only place you get understanding is with other IRS people."

When Schickel was hired in 1981, the IRS was decentralized. The 33 districts throughout the country each had their own criminal investigation, collection, audit, and customer service departments. Every district was like an extended family. Employees knew one another. They played softball together. They went out on social gatherings. "Most of them were just decent people," Schickel says of his

erstwhile co-workers. He's still friends with many of them.

It became more challenging for IRS employees to enjoy each other's company in the late 1990s, also a dark period for the service. Congressional Republicans held hearings in which IRS employees were depicted as jackbooted thugs. Schickel, who's writing a book about the agency, concedes there was some truth to the characterization. But he takes issue with the government's response. In an effort to make the IRS more accountable, President Bill Clinton signed a sweeping reform bill that reconfigured the agency into four national divisions serving different types of taxpayers—individuals, small businesses, large corporations, and nonprofits. "Your boss might be in San Francisco, but you were in New Jersey," Schickel says. "How did that happen?"

It wasn't all bad. During the eight years of George W. Bush's presidency, the IRS had enough money to send employees with various specialties to training sessions where they'd sharpen their skills and

“We weren’t able to meet physically for about three years. You have all these people working in isolation”



trade war stories. “We were in Chicago one year,” says Sharyn Phillips, an IRS estate tax lawyer in New York. “We were in Kansas City one year. The good thing about it was that you could share your experience. Every year, Congress is tinkering with the tax code. Estate taxes have changed dramatically.” It helped make up for the lack of office pantries with free coffee. Workers might not have had the newest computers, but the service provided them with adequate tech support.

It looked as if the IRS would be funded at previous levels, if not higher, when Obama took office in 2009. In the first year of his presidency, the Democratic-controlled Congress approved a \$12 billion budget for the following year. It also gave the agency more work to do when the Affordable Care Act and another law increased filing requirements for Americans overseas. Then, in 2011, Republicans settled into the House, and the cutbacks started. According to the U.S. Government Accountability Office, the IRS reduced technology spending that year by \$165 million. Schickel says it became almost impossible to get people from tech support to help with a computer problem. This was when the agency was finally going through a difficult upgrade from Windows XP to Windows 7. “A lot of people in the office had laptops. Every time they loaded Windows 7, it completely crashed,” he says. “They didn’t have enough memory. It’s like Congress is against you, the computer system is against you, and you are just fighting to get your job done.”

Many IRS veterans have similar stories about the software switchover. “It’s been really tough,” says Jenny Brown, a tax examiner in an IRS facility in Ogden, Utah, and president of the local National Treasury Employees Union (NTEU) chapter there. “There were times when I actually called my sons and said, ‘OK, how do I do this?’ And they tried to walk me through, because there just aren’t enough people here to do it.”

In 2012 the IRS reduced its training and travel budget by \$54 million. That might not sound like much for an agency with a multibillion-dollar budget, but it punctured morale further. It became difficult, if not impossible, for employees to get together in one location. “The members of our team were scattered all around the country,” says David Stanley, an IRS research program manager who worked in Oakland, Calif., until his retirement last year. “We weren’t able to meet physically for about three years. You have all these people working in isolation.”

The IRS all but stopped sending managers to conferences to speak to accountants and other tax professionals about what could trigger an audit. It wasn’t just the cost of traveling. Ron Cerruti, a former territory manager in San Francisco, says the service was nervous that employees would say something controversial and embarrass it after the scandals of 2013. “I remember one time I was invited to attend a meeting at a hotel in San Francisco about four blocks from my office,” says Cerruti, who also retired last year. “There would have been no travel costs. I couldn’t get permission to go. They were afraid of what we were going to say in front of an audience of external people.”

“We were on a gag order,” says Taylor.

“I mean, it was ridiculous. We couldn’t talk outside of the organization.”

IRS employees give Koskinen high marks for his efforts to rejuvenate morale. An unwaveringly upbeat 75-year-old with an oval face, high cheekbones, and large blue eyes, he never misses a chance to extol his workforce. Koskinen spent much of his early months as commissioner meeting with employees around the country and listening to their gripes. Managers told him they hadn’t seen their team members in person for ages. Employees frequently brought up the gutted tech support operation. “I had people stand up and talk about how there used to be 12 people on the help desk in their area and now there were three,” Koskinen says. “I told employees, ‘Now you know what it’s like to be a taxpayer trying to contact us.’”

Koskinen has tried to restore some of the IRS’s funding, but it hasn’t been easy. In December, Obama signed a 2015 federal spending law that lowered the IRS budget by 3 percent, to \$10.9 billion. The same month, Koskinen said the agency would halt most overtime payments and answer fewer than half of incoming telephone calls from taxpayers during this year’s filing season. The IRS now tells customer service reps they can no longer spend time

Fig. 4
Fiscal year appropriations

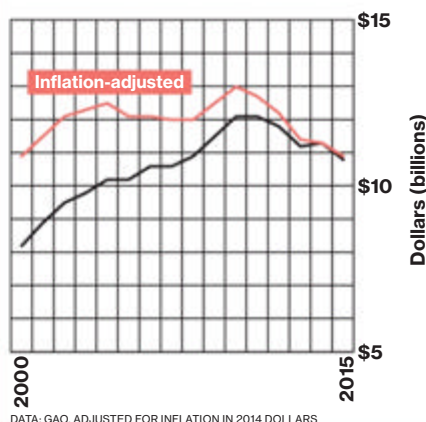
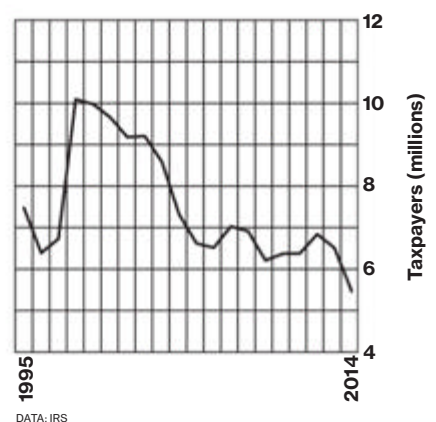


Fig. 5
Walk-in assistance delivered



on the phone answering complicated tax questions. Instead, they urge people to go to the IRS website or hire an accountant.

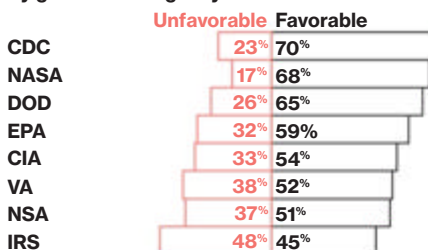
Frank Spadea manages an IRS call center in Philadelphia, where employees sit in a cubicle farm and field questions from Americans in foreign countries. His group used to have 51 employees; it's down to 17. Of those, he expects at least two to retire this year, and they won't be replaced. "It's been seven or eight years since I've been able to hire," he says. Meanwhile, his staff has been overwhelmed with calls this year from Americans overseas who are confused about extra information they're supposed to furnish under the 2010 law combating tax cheating abroad. "They are calling like crazy about that," says Donna White, a customer service representative in the office. "You kind of get burnt out."

Koskinen has asked for more money in 2016, but it doesn't look good. In March he made his case before a House subcommittee that oversees the IRS's budget. "I thought it was a good discussion," he said afterward. "It wasn't contentious in the sense of, 'Have you stopped beating your wife lately?'" But Representative Ander Crenshaw, a Florida Republican and the subcommittee chairman, was unmoved. He says the IRS has enough money to carry out its mission. Asked about the lamentations of its employees, Crenshaw says, "We're not out to punish them. We're out to make them more efficient, and I want them to keep working on that."

Some Republican leaders seem more interested in exploiting the scandals. The investigations into the Tea Party affair continue after almost two years and more than \$20 million spent on them. Congressional investigators are pursuing missing e-mails sent by Lois Lerner, who oversaw the agency's nonprofit division before she was nudged out in 2013. (William Taylor, her attorney, declined to comment.) "The

Fig. 7
Public opinion

By government agency

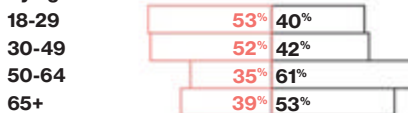


How the survey pool breaks down on the IRS:

By gender



By age



By party



DATA: PEW. FIGURES MAY NOT ADD TO 100% BECAUSE OF ROUNDING

public's lost faith in the IRS," says Senator John Boozman, an Arkansas Republican and chairman of a subcommittee that has jurisdiction over the service. "It's really important to have faith in institutions. Now we're [Congress] at an 18 percent approval rate, so it's hard to pick on them." Perhaps, but that isn't stopping anybody on Capitol Hill.

IRS employees dread the political theater more than the budget cuts. "Every time one little thing is found, it's blown up to some big conspiracy," Dorothy Taylor says. "It's disheartening to the employees in the organization, and that's why a lot of people like myself have left. You get tired of being beaten down and having resources with-

held. I was there when the tax-exempt [Tea Party] thing started. It had nothing to do with the examinations where I was, but it affected the whole organization."

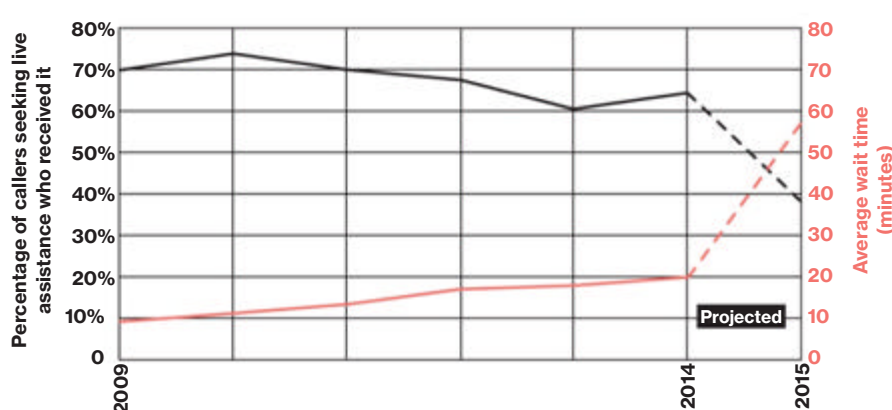
David Carrone, a revenue agent in New Orleans and president of the NTEU chapter in Louisiana, is similarly disgusted with the never-ending cycle of hearings and castigations. "That's the No. 1 downer as far as morale is concerned," he says. "I shouldn't have to say this, but the IRS brings in approximately 93 percent of the revenue of this country. We're not soldiers here, but we are serving our country."

Schickel says the political attacks made his job more difficult and potentially more dangerous. Throughout his career, he dealt with antigovernment tax avoiders in Arizona, but once the Tea Party scandal broke, his encounters with otherwise law-abiding ranchers became more hostile. "I used to work Tombstone," he says. "They hate the IRS down there. It's a hard enough thing to drive out, bang on somebody's door, and make a legal demand on them for money. It's even harder when the person is wearing a gun on his hip and says, 'I saw on TV that you people are discriminating against the Tea Party.' That's when I decided, the hell with this!"

The fear in the IRS is that vilification of the service will hurt Americans' high voluntary compliance, which makes the country more financially stable than, say, Greece, where much of the population declines to pay taxes altogether. Beleaguered IRS workers worry that citizens will test the system to see what they can get away with. "Once you go in that direction, it's not an off/on switch," Koskinen says. "You can't turn it around the next day by saying, 'Whoops, I take it back. It's a really good agency, and they are doing good work.'"

Koskinen says he hasn't seen any evidence of compliance erosion, but he could be in the dark. In 2012 the IRS estimated that it collected 83 percent of the taxes it was owed from people who had paid on time and without prodding, but that number was extrapolated from 2006 data, before the funding crisis began. "Historically it's stayed at a good level," Koskinen says. "But we have 5,000 fewer revenue agents, revenue officers, and criminal investigators than we had five years ago. That has an impact." Which is why Ficco, in West Nyack, continues to do her job, even if she has to purchase her own supplies. She doesn't want to see the U.S. go the way of Greece. "Absolutely," she says. "It is the ultimate goal, and it's sad that we have people out there trying to do the right thing, and we're putting up roadblocks in front of them." **B**

Fig. 6
Phone service



DATA: GAO

Twenty-five miles off Libya's coast in October 2014

Dying at Euro



For people who court danger in foreign lands, Chris Catrambone is a good guy to know. Originally from Louisiana, he made his first \$10 million before age 30 investigating insurance claims and lining up medical care for injured workers in some of the world's most violent places, especially contractors of U.S.-owned companies operating in Iraq and Afghanistan. In 2008, at 27, he moved his two-year-old multinational company, the Tangiers Group, to Malta, the island nation in the central Mediterranean that's been vital to

various empires for more than two millennia, and where moorings are as common as parking spots. Tangiers Group's portfolio includes travel insurance, up-to-date CIA World Factbook-type reports on emerging markets, and hospitalization and evacuations for expats.

In the summer of 2013, with his wife, Regina, and stepdaughter, Maria Luisa, Catrambone chartered a yacht for a trip to the coast of Tunisia with a stop on the Italian island of Lampedusa, a popular vacation spot. It's also a landing point used by migrants

More people die trying to reach Europe across the Mediterranean Sea than at any border in the world. An Italian-American couple launched their own search-and-rescue service to save them

By Brad Wieners

Europe's Doorstep



trying to enter Europe illegally. As the Catrambones left the harbor, Regina spotted a parka floating on the waves. It struck her as incongruous—a winter coat being carried by the warm tide—and she asked their captain about it. He replied that it had almost certainly belonged to one of the thousands who've attempted a water crossing to Lampedusa from Libya in inflatable dinghies—one who didn't make it. "Lampedusa has a beach called Rabbit Beach, and every year it's rated as one of the top beaches in the

world, so of course we wanted to visit it," Chris says. "But then we learned that there are bodies of refugees literally washing ashore on this most beautiful beach. So what, you're going to have a nice swim in the same water where these people are dying? Is that right?"

That afternoon, and well into the night, he and Regina discussed what Pope Francis, on his first visit outside the Vatican, had described as "the globalization of indifference" to the plight

of refugees at sea. “Papa Francesco said that everyone that could help, should do it, [and] with his own skills,” says Regina, who speaks English as well as her native Italian. “So we start to think, what are our capabilities? We have a good background in helping people in trouble.”

As with the U.S.-Mexico border, immigration is a perennial, intractable problem for the coastal states of Southern Europe, but it’s become a full-on humanitarian crisis in the four years since the Arab Spring. In 2014, 218,000 irregular migrants (the inelegant term of art for refugees and those traveling without documentation) tried to reach Europe by crossing the Mediterranean, according to the Office of the United Nations High Commissioner on Refugees (UNHCR). That’s more than five times the number that tried in 2010. Some are from poor nations in sub-Saharan Africa, simply seeking a better life. Most have fled civil wars and lawlessness in Syria, Eritrea, and Somalia. Last year at least 3,419 died in the attempt, making the Mediterranean the world’s most lethal border crossing.

If early numbers are any guide, 2015 will be worse. In January and February of 2014, 15 migrants died at sea. During the same two months of this year, 450 have perished. On March 3 and 4, several cargo ships and the Italian Navy plucked 1,000 migrants from the Mediterranean in seven separate operations. Among the 10 who died that week, several had already succumbed to hypothermia before the rescue teams arrived. “It’s not just young men,” says William Spindler, a UNHCR spokesman, “but professionals, pregnant women, young children.”

In Libya, the busiest launch point for sea crossings, the gangs who run the human smuggling operations charge somewhere between €1,500 (\$1,625) and €5,000 for passage. Migrants are moved by bus or marched to camps near the coast where they await a boat. During this time, they are treated little better than hostages. The boats are whatever the smugglers can scrounge, and, in account after account, migrants report being ordered aboard, often at gunpoint, in unsafe numbers. More than a hundred will pile into a decrepit wooden fishing boat or a single rigid inflatable boat, or RIB. At the 3 or 4 knots the outboard motors can muster, it takes, on average, 40 hours to reach Lampedusa—40 hours during which

the travelers are exposed to the elements with little food or water and nowhere to relieve themselves except over the side. High seas or a bunch of people moving toward one gunwale at once is all it takes to swamp the RIB’s interior.

European governments have struggled to devise solutions to the crisis. Following two tragedies near Lampedusa in 2013—on Oct. 3, when 366 died, and Oct. 11, when dozens more perished—the Italian Navy and Coast Guard added additional patrols under a program called Mare Nostrum. In 2014, at a cost to Italy of €114 million, Mare Nostrum seized eight ships, arrested 728 suspected criminals, and saved 100,250 people, according to the Italian Interior Ministry. But by providing foreigners safe passage into Italy, the program was criticized for adding to the country’s immigration problem—particularly at a time when unemployment hovers near 13 percent. Italy canceled the Mare Nostrum program last November, turning instead to Operation Triton, a more limited effort coordinated by Frontex, a border police agency funded by the European Union.

Although friends advised them that it was a problem best left to government agencies, the Catrambones decided they’d launch their own search-and-rescue outfit. Marco Cauchi, a veteran of the Armed Forces of Malta (AFM) and the captain of their vacation yacht, says Chris’s head “is like marble. If he says he wants to do something, he does it.” Shortly after their cruise, they established a nonprofit, the Migrant Offshore Aid Station (MOAS), based out of the Tangiers Group office, and recruited Martin Xuereb, a 47-year-old retired AFM general, to be its director. Chris then dispatched a broker to find him a suitable vessel. He ended up purchasing a 40-meter (136-foot) Canadian fishing boat in Norfolk, Va., for €1.6 million. She’s a trawler with a high bow and an open stern, well suited for hauling people aboard. Chris says her name, *Phoenix*, was part of the appeal. He joined the crew for the Atlantic crossing, his first. Cauchi’s now the *Phoenix*’s skipper.

Between the end of August and October of last year, the *Phoenix* took part in 10 rescues and came to the aid of 3,000 migrants, 1,462 of whom came aboard the *Phoenix* for several hours, before being offloaded to larger Italian ships, or a couple of days, before arriving at detention centers in Sicily. MOAS doesn’t decide where to bring them but follows instructions from the Maritime Rescue Coordination Centre in Rome.

To return to sea this May—the number of irregular migrants crossing the Mediterranean surges in warmer weather—Catrambone’s team has embraced an intense period of fundraising and has even begun looking for a bigger boat. With much of the Middle East embroiled in chaos, every indication points to this summer as the most challenging yet. “We’ve been told there are between 500,000 and 1 million migrants ready to leave Libya,” says Frontex Executive Director Fabrice Leggeri. “We need to be ready to confront a situation that will be tougher than last year.”

It’s bound to be a tougher year for MOAS, too. On a tactical level, they’ll probably have less access to Italian ships for transferring those they’ve rescued, and will have to travel farther, at greater expense, to bring them to relative safety. At the same time, the novelty of their freelance coast guard act is bound to wear thin in the face of a backlog of irregular migrants already sitting in detention centers and a nasty nationalist backlash against asylum seekers throughout Europe.



Chris Catrambone

A dusty block of limestone and clay 9 miles wide and, at its farthest reach, 17 miles long, Malta is perched above the fault between the Eurasian and African tectonic plates, due north of Libya. It's home to roughly 410,000, mostly packed into a few bustling, dense cities with narrow streets. If the yellow and white stone architecture has an Arabic feel (Brad Pitt cast the Maltese capital of Valletta as Jerusalem in *World War Z*), the cafes and boutiques seem more European. Locals, too, reflect a cosmopolitan mix. One's bloodlines enter small talk the way prep schools and Ivy Leagues do at a Wall Street soiree. Like in all island countries, everyone seems to have multiple jobs and to know how to repair anything; young Maltese strivers leave before they're comfortable staying on. It's a border town in the middle of the sea, and its *Casablanca*-vibe clearly thrills Catrambone.

"It's always been a draw for tourists, but it's picking up for financial services, too," he says. "We're 90 minutes to Rome, three and a half hours to London. I can be in Kabul the same day. It's really happening now." While he may not be wrong about that, his enthusiasm is somewhat self-serving. In late February, the Tangiers Group purchased Osprey Insurance Brokers, the insurance underwriter for Malta International Airport and Air Malta, its lead carrier. The airport has said it expects to receive 5 million travelers this year. Catrambone's also paid for a new office for Tangiers Group—a multifloor modern renovation behind an historic facade—in Valletta. MOAS will remain in Sliema, across the harbor.

Catrambone, 33, is six-foot-three with a full Hemingway beard. There's a stripe of gray in front, but a dimple above the brush lends him a surprising boyishness. One senses that he navigates war zones by being disarming, not overbearing. He's nothing if not sincere, and he's still adjusting to media attention. "How'm I doing?" he inquires after a mini-monologue.

Following an interview in the MOAS office, he leads a tour of the *Phoenix* in an intermittent March drizzle. He wears a stylish pea coat, scarf, and chukkas. The *Phoenix* is tied off at Malta's Bezzina Ship Repair Yard between a massive, dry-docked yacht belonging to a Barclays director and the *Che Guevara 2*, a motor yacht/salvage job that once belonged to Saif Qaddafi, the disgraced son of the former Libyan despot. The *Phoenix* has a reinforced steel hull that's strong enough for ice-breaking. Below the main deck, workers sandblast one side and add fresh primer to the other.

Catrambone points to a bull's-eye painted on a raised platform: the helipad for two Schiebel Camcopter S-100 drones he leased. "They're rotary-based helicopter drones that have an HD video camera," Catrambone says, beaming. Having the drones, he says, "extends the boat's visibility by 60 nautical miles, easily." He adds, "We got a great deal for them," but the drones still run north of €1 million for a few months. (MOAS and Schiebel declined to provide an exact figure.)

Even if they're not strictly necessary, Catrambone is willing to pony up for the S-100s to make a point: that NGOs, like for-profit businesses, ought to take advantage of the best available technology. "You know, a lot of people get really upset when they hear about drones, because all you hear about is drones killing people. We wanted to change that dynamic." To avoid inciting panic in the overcrowded migrant boats, the S-100s fly at an altitude where they're barely visible, says Chris Day, the head of capability engineering at Schiebel. The drones have proven most useful at spotting distressed vessels at night as they also carry infrared cameras.



Near Malta's Hal Far Immigration Center

Along for the *Phoenix* tour is Robert Young Pelton, a Zelig-like American journalist, filmmaker, and folding knife merchant (under the DPx Gear label) who first made his name with a survival guide, *The World's Most Dangerous Places*. Since it was published in 1993, Pelton himself has survived a kidnapping by the AUC, Colombia's notorious death squads; a 36-hour broadcast marathon after his discovery of the so-called American Taliban, John Walker Lindh, in Afghanistan; and a 2013 crowdfunded manhunt for Joseph Kony, the messianic Ugandan accused of enslaving tens of thousands of child soldiers. (In 2011, Pelton also published an investigation of Somali pirates in *Bloomberg Businessweek*.) Pelton is clearly one of Catrambone's heroes, and now he's hired Pelton to help transform MOAS from a bootstrapped startup into a sustainable NGO.

The first two or three times Catrambone called him to compare notes, Pelton says, he wasn't quite sure what to make of him. "Chris talked in these long, elliptical paragraphs about what he hoped to do, but it was difficult to know if he had the practical know-how," he recalls. But Catrambone won Pelton over because he put himself on the line—his money, his boat, his person. "The people who change things are the ones that take risks. Yes, there may be some side effects, but MOAS has had a measurable impact in a number of ways."

The ship's first rescue was on Aug. 30, 2014, about 30 nautical miles from Libya. "You had several boats, including one filled with children that was getting ready to capsize," says Catrambone. "You had the water coming up—the boat was filling up, the children were screaming and crying, many of them didn't know how to swim." Before it was over, more than 100 people were in the drink, floating with the aid of MOAS's plastic orange life jackets. Once the crew had everyone aboard, they almost ran out of infant formula. "On that day, it went from zero to 358 immediately. And it was no holds barred for the next 20 hours."

It takes about €250,000 a month to keep the *Phoenix* operating at sea. The Catrambones had told their chief financial officer that MOAS would cost €1 million, maybe a million-five. By the time they had finished for the year, it had set them back \$8 million—all from the Tangiers Group and their personal funds. On the bridge of the *Phoenix*, Catrambone and Pelton are cagey about ongoing negotiations for substantial contributions from

a few better-established NGOs. On April 8, Médecins Sans Frontières (Doctors Without Borders) confirmed to Bloomberg that it will team up with MOAS and provide funding, several tons of supplies, and emergency medical technicians and mental health specialists to go on *Phoenix* missions. It's a rare collaboration for MSF that's worth roughly €1.4 million to MOAS. This spring, MOAS also accepted funding from Jürgen Wagentrotz, the chairman of Germany's Oil & Gas Invest and president of its American holding company in Alabama. Wagentrotz has pledged €60,000 a month for six months in 2015.

Another financing approach MOAS has considered, Pelton says, is to work on behalf of commercial shipping lines, shadowing merchant vessels and responding to boats in need so the freighters don't have to. Under maritime law, every vessel has an obligation to respond to another vessel in distress. MOAS Director Xuereb points out that "the difference between us and a merchant vessel which is carrying crude oil is that while we both have the same obligation to assist, the mission of a tanker is to carry oil from place A to place B, and then, only if he's called upon, to stop. Our mission is stopping." In 2014, 800 merchant ships responded to emergencies in the Mediterranean, according to Peter Hinchliffe, secretary general of the International Chamber of Shipping, at a cost of \$50,000 to \$80,000 an incident, depending on how long the emergency delayed delivery of their cargo. In many cases, container ships and tankers aren't the right vessels for the job, say Hinchliffe and Steffen Conradsen, Maersk Line's director and head of incidents and crisis management. It takes incredible seamanship to bring a tanker alongside an overcrowded dinghy without crushing it. They don't carry extra food. The crews usually don't include a doctor, and they're often small; if 300 or 400 migrants come on board, they could outnumber the crewmen 20 or 30 to 1.

Catrambone is touchy about the cost of running MOAS. He points out that in NGO terms, he has almost no overhead. "Everybody is doing advocacy. We're picking people who are drowning out of the water, and we're doing it efficiently. The more dollars we have, the more lives we save. Who can you say does that?"

Catrambone grew up in Lake Charles, La., his father's only son; he has half-siblings from his parents' multiple other marriages. His dad, a liquefied natural gas engineer, worked overseas a lot, in the United Arab Emirates, Algeria, and elsewhere, and gave Chris a RadioShack shortwave transistor radio so he could listen to English-language broadcasts from wherever his father was. In his bedroom, Catrambone mounted a large world map and kept track not only of his father's movements but of natural catastrophes, conflicts, coup d'états. The map may not be his Rosebud, but it was clearly preparing him for his life today.

"I never really talked about it or shared it, with the exception of one of my favorite teachers in eighth grade, Mr. Book. He was the greatest geography teacher you could ever imagine. It was almost circuslike. You'd give him a longitude and latitude, and the guy could literally tell you the exact city, country, and every single thing about that location. It was amazing."

Catrambone graduated from McNeese State University in three years and pursued some postgrad studies at Charles University in Prague and Florida State. He moved to New Orleans and found work as a private investigator, helping insurance companies determine if their clients' claims were legitimate. In August 2005 he found himself in Nassau, Bahamas, looking at documents at a local courthouse, when Hurricane Katrina hit. By the time he made it home, his flooded neighborhood had been condemned.

"Because we couldn't live there anymore, all my friends and I put our FEMA checks together and opened a Cajun restaurant on St. Thomas called Cajun Marie. I'm serious. You can look it up," Catrambone says. The experience taught him to avoid the restau-

rant business, but "ours was the only place on the island where you could get authentic gumbo and high-octane bloody marys. It was kind of a period of time of mourning after Katrina. It kept us alive that year."

Catrambone had never stopped doing claims investigations, even while helping out at Cajun Marie, and as more private contractors shipped out to support the U.S. military in Iraq and Afghanistan, he took on more commissions in conflict zones. He came closest to being killed on the job in Ma'alot, Israel, which was targeted by rockets from Hezbollah in Lebanon while he was there in 2006. Ignoring an ambulance driver's warning, he approached the house of the family he needed to check on to see if someone receiving a medical disability check there was still alive. Well, he was—and he told Catrambone to follow him immediately back into his bomb shelter. A rocket landed right where Catrambone had been. "It's insane, man. I've risked death in Afghanistan and Iraq, all over Africa, countless times. But that was random. That would have been some way to go."

Catrambone met Regina while tracing the roots of his family name in the Calabria region of Italy. They've been business partners for almost as long as they've been a couple. MOAS, they both say, has been the hardest thing they've done, starting with getting the *Phoenix* to Malta. Halfway across the Atlantic, the *Phoenix* struck a submerged object and stopped moving. They hadn't gone through Bermuda, but instead were heading straight for the Azores—so there was nothing near them, certainly no hope of a tow. They didn't have proper dive equipment to investigate the propeller themselves. The seas turned rough. "We all decided that before we started panicking and just abandoning this idea, let's see if whatever had got caught would come off if we started maneuvering," says Chris. "So we turned on our thrusters to see if we could maneuver out, and we eventually shook off whatever we hit." They later found a huge gash in one of the blades, but no one could say exactly what they'd hit.

Like her husband, Regina, 40, has gone to sea on the *Phoenix* and taken part, as crew, in several rescues. Her last mission stands out. "It's Oct. 28, so it was already cold. The sea was rough, and it was raining. Even though we had blankets for everyone, we couldn't fit them all inside"—that space was reserved for women and small children. "You understand that when you have 331 persons on board a 40-meter ship, plus us in the crew—we were 351 on board. We were waiting 36 hours on that boat sharing the space with the migrants." They let them out at a Sicilian camp.

You cannot complete a rescue unchanged, she says. "These are difficult emotions to explain. Always I thought that it's important to help. It's our duty to help each other, but living the experience like this... Sometimes I don't think they realize the danger they are in because they're so stuck on top of each other, like a puzzle. We break this puzzle and give them identity again."

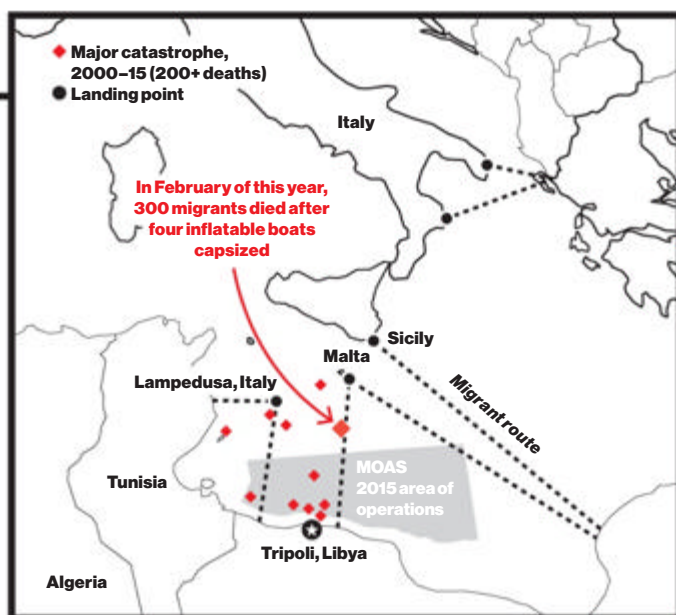
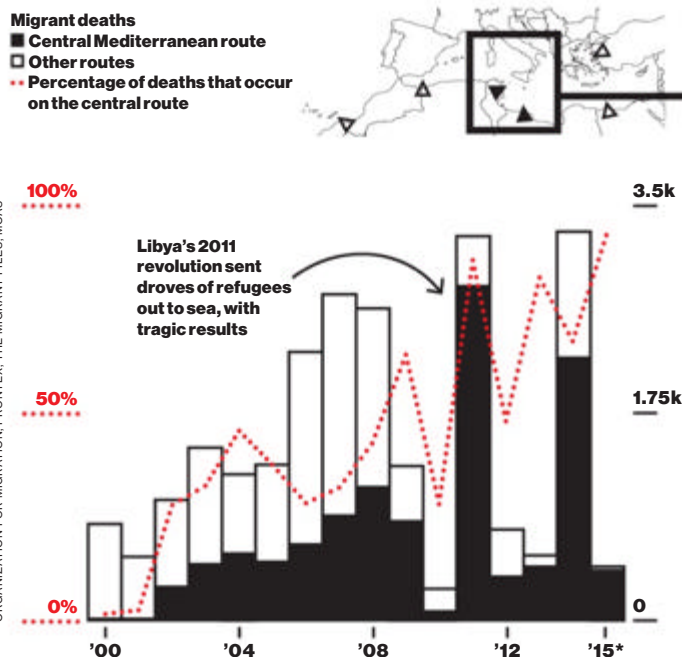
Like those the *Phoenix* took to Sicily last October, Mohammed

Kazkji is among the fortunate ones, although he's haunted by what he endured. A 22-year-old electrical engineering student from Damascus, he'd traveled to Libya to find work and support his family during the Syrian war. Then Libya became just as dangerous, and he paid €1,000 to get across the Mediterranean, the first leg of a journey he hoped would bring him to the Netherlands. He survived a crossing that claimed at least 50 lives on Oct. 11, 2013, but barely. Speaking from Malta, where he lives today, he describes a disregard for human life that's surpassed, perhaps, only by Islamic State.

"We were maybe one hour from shore when another boat came and demanded more money from us, and then began shooting at us," Kazkji says. It was dark—and impossible to tell if the assailants were the same smugglers who sent them off or a rival gang. "You put your head in your arms and hope the bullet doesn't find you,"

Lost Ones

According to the International Organization for Migration, 65 percent of all migrants worldwide who died in 2014 perished in the Mediterranean. Their database of migrant deaths, culled from news reports and eyewitness accounts, reveals that over the past 16 years more than 11,500 have died trying to reach Italian or Maltese territory by sea.



he says. He recalls a woman who held a small child aloft as an appeal for mercy. “She puts her boy out and says, ‘Look at my small boy, I don’t want to die with my boy. Please don’t shoot the boat.’ They understand the language, and still they start to shoot.”

Sometime after midnight, their tormenters left. By dawn, Kazkji was asked to help lift corpses over the side, and the boat had begun to list. The two or three hand-pumps on board were nowhere near up to the task, and by midmorning, Kazkji was swimming. He can’t say for sure how long, maybe a couple of hours. The number of dead steadily bloomed around him. “When you swim, you find the kids, you don’t know who belongs to who. There were so many families.” At one point he came face to face with a small boy, “with the blue face. And you know he is dead.”

Kazkji was rescued by an Italian government vessel, part of the Mare Nostrum operation. He even made it to the Netherlands but was “Dublined” back to Malta. Dublining refers to the Dublin II regulation that applies throughout the European Union. Ratified in Ireland in 2003, it permits a member state to forcibly return asylum seekers to the first EU country they entered. Human-rights activists point out that Dublin II doesn’t require countries to do this but grants them the option. There aren’t many EU countries waiving this option, however. Iverna McGowan, the acting director of Amnesty International’s European Institutions Office, says European countries have agreed to resettle just 10 percent of the 380,000 Syrian refugees identified by the UN as “most vulnerable”—torture and rape survivors and those who are ill.

Nothing, McGowan says, “is undermining the EU’s and member states’ credibility on human rights at home more than its response—or lack thereof—to the spiraling humanitarian crisis in the Mediterranean Sea.” In Italy and Greece, some politicians argue that helping migrants will not only take jobs away but invite terrorists in. “Have in mind [that] not all of the travelers are actually travelers but terrorists or candidate terrorists who seek to find ties with extreme Muslim communities that are preparing a retaliation in the heart of Europe,” warns Artemis Matthaiopoulos, a member of Greece’s parliament representing the Greeks-first Golden Dawn party, in an e-mail to Bloomberg.

MOAS’s Xuereb rejects such alarmist rhetoric. “Let’s say I am a terrorist in Libya, and I want to come to Europe. Why would I take a boat that I know for sure is going to be stopped, and then spend a long detention period—not to mention that there’s a great possibility of me drowning first?” Another criticism of rescue operations is that they “become a taxi for migrants, a taxi on demand,” as former Italian Defense Minister Ignazio La Russa said last May. “Why don’t they make [Mare Nostrum] into an operation aimed at pushing back migrants, escorting them back to where they left from?”

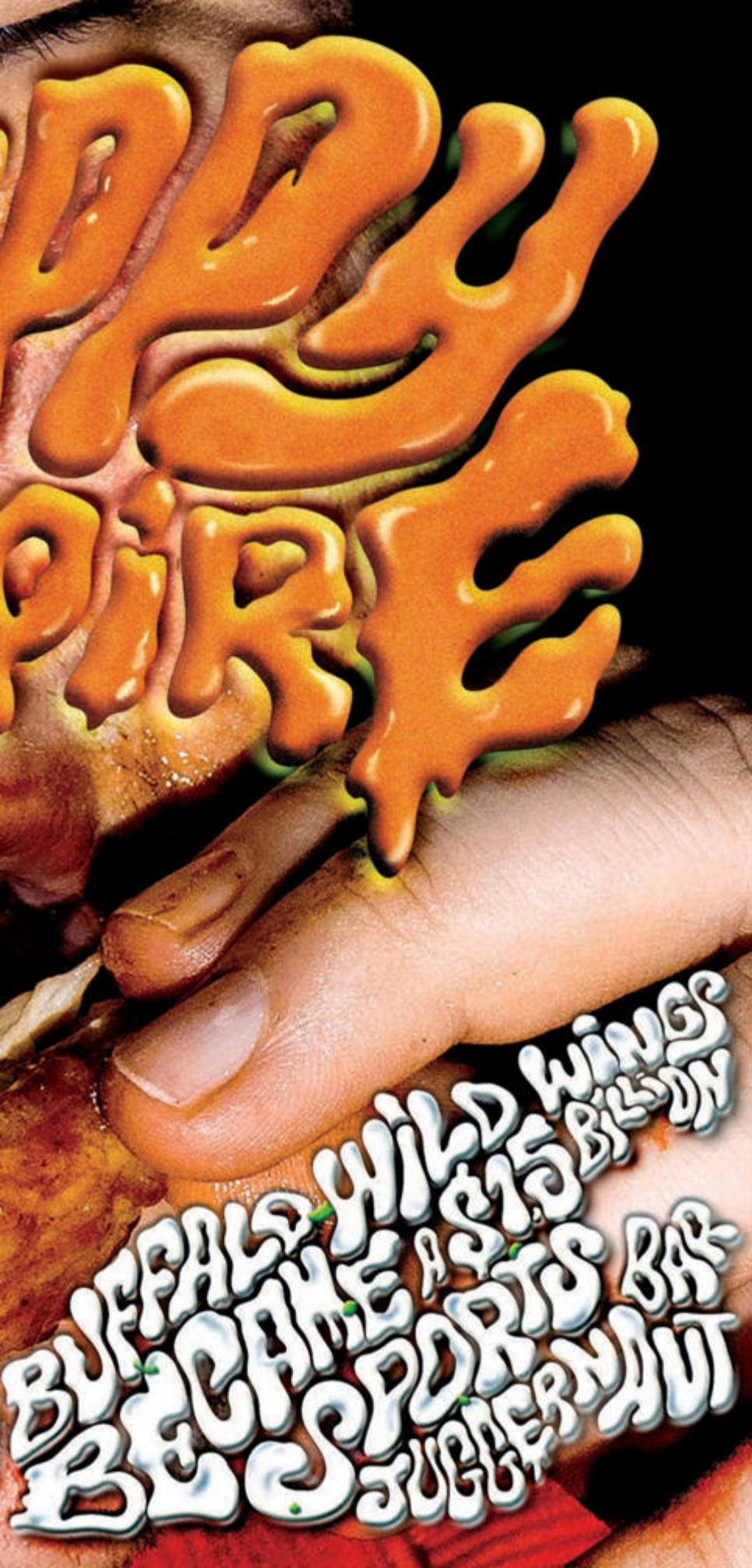
Xuereb also disputes the suggestion that scaling back on rescue capability will deter migrants from coming. The conditions in Libya, which he visited repeatedly with Malta’s armed forces, have deteriorated so badly, he says, “that thousands feel their lives are over if they don’t escape.”

Catrambone says that with the end of Italy’s Mare Nostrum program, the *Phoenix* won’t be able to transfer refugees as readily to Italian Coast Guard ships. Instead, “I expect we will be asked to disembark them on land,” in detention centers like the ones on Sicily, a strain on the *Phoenix*, which is not particularly fast. This is why he’s hoping to find a way to get his hands on a Swift, a 98-meter-long Australian car ferry that can do 42 knots and has a vehicular cargo bay that could be reconfigured to shelter as many as 2,000 people at once. Operating a bigger boat, of course, will also make Catrambone a bigger player in the debate over how to deal with the refugee problem—and a more inviting target for politicians who wonder whether a private citizen from the U.S. should be interfering in an issue of extreme sensitivity for Europeans.

Thus far, Catrambone has done his best to duck controversy, but sometimes he can’t help himself, as when he recently called the migrant crisis, “a second Holocaust.” Pressed on whether that’s hyperbole, he clarifies but remains emphatic. “Am I saying that a European country is gassing people right now and putting millions to death? No, I’m not saying that. What I’m saying is that thousands of people are dying on Europe’s doorstep, and people don’t want to see it.”

—With Alessandra Migliaccio and Maria Petrakis





By Bryan Gruley

Photographs by Ryan Lowry

The chicken wings arrive by semi before dawn, 2,250 pounds hustled in through an unmarked door at a strip mall in Germantown, Wis. Two men unload the prized cargo along with 69 gallons of sauce. Seventeen hours later, with the Wisconsin Badgers fighting from behind against the North Carolina Tar Heels, the wings are flying from a storage room cooled to 28F into a cramped kitchen where a dozen cooks jostle amid shouted orders, sizzling grease, and the occasional shrieks of an alarm urging them to move faster. Monitors overhead flash orders from the 20 waiters and bartenders working tonight at Buffalo Wild Wings.

Kyle Turner, a husky prep cook in a black-and-yellow Wild Wings T-shirt and cap, dumps six freshly fried wings into a plastic pail labeled Parmesan Garlic. He pivots right, pumps an ounce of sauce into the pail, slaps on a lid, swivels left, shakes the pail with both hands, sets the lid aside, and then drops the wings into a cardboard carton. It takes six seconds. Next to Turner, fellow “shaker” Brian Glover spins a pail, no top, marked Asian Zing. “The top slows me down,” he says.

The sauced wings are piled onto a tray alongside celery, dressings, and fried cheese curds. Eight minutes after the order came in, waitress Alyssa Kark carries it out into a sea of cheering Badger fans. She squeezes past the throng at the bar and sets her tray before three Wisconsin faithful gazing up at a television almost as big as a garage door. “Awesome,” says Jesse Povlich, a machine-shop manager in a red-and-white Badgers shirt. “We’re going to win,” he says, biting into his first wing.

Povlich was correct. Wisconsin beat North Carolina, knocked off the undefeated University of Kentucky in a Final Four epic, and then lost to Duke in the championship game. The tournament’s biggest winner might be Buffalo Wild Wings, whose “Wings Beer Sports” motto has been a recipe for victory in the restaurant industry. The Minneapolis-based chain has grown from about 300 U.S. locations to more than 1,000 in the past decade, with sales and a stock price that are the envy of Olive Garden, Outback Steakhouse, and other rivals. Profit last year rose 31 percent, and its share price has jumped 45 percent since mid-October.

The casual-dining industry, characterized by table service and moderate prices, scraped out sales growth of 2 percent last year, according to NPD Group. Sales at Buffalo Wild Wings’ company-owned and franchised stores grew about 6 percent. Even after it raised prices last fall to offset the surging cost of chicken

wings, sales were up more than 11 percent in January. On a single day in February—Super Bowl Sunday—customers gobbled up 11 million wings.

B-Dubs, as regulars have nicknamed the chain, plans to add 90 stores this year. Chief Executive Officer Sally Smith says she thinks there's room for an additional 600 in North America, especially on the coasts. The company has more than 20 outlets in Canada, Mexico, and the Philippines and plans to keep expanding abroad. Last year it bought stakes in emerging fast-casual chains PizzaRev and Rusty Taco, which Smith describes as “little bets” for when the Buffalo Wild Wings expansion tapers off at home.

Wild Wings restaurants won't make any Michelin list. Wings are about \$1 apiece and available in an almost comical number of varieties: regular or boneless, with five dry seasonings and 17 sauces with names like Jammin' Jalapeño and Thai Curry arrayed on a heat scale. The rest of the menu is sports bar standard—nachos, mozzarella sticks, burgers—and the beer list isn't terribly adventurous. Most people don't need to leave home to watch their favorite team on a state-of-the-art TV. But the chain appeals to a wide band of customers, from pub-loving sports nuts to families looking for a cheap night out. Revenue was \$1.5 billion last year.

The formula is evident at the company's newest restaurants, which have been rolled out around the country over the past two years. The high ceilings and blond finishes upend the dank-and-dark stereotype of the sports bar. At the Germantown location, the mixed crowd is spread across several barrier-free zones: Customers in Badger garb gravitate to the high-top tables dotting the floor around

the bar; families with young children stick to the carpeted areas with booths. At least five of the 53 TVs are visible from any seat.

There are trivia games and wing-eating contests for adults, video games on tablets for kids. “We consider ourselves to have 1,100 stadiums,” says Ben Nelsen, vice president for guest experience and innovation. “We want to have a piece not only of that food dollar but that entertainment dollar.”

Smith, 57, an accountant who's partial to spicy garlic wings, has run Buffalo Wild Wings for almost 20 years. She says when she and her chief financial officer, Mary Twinem, pitched the company's initial public offering in 2003, investors kept asking, “How can two women run a sports bar-and-grill?”

During a tour of a new location in Edina, Minn., near company headquarters, Smith explains how the buffalo logo laser-etched onto the chain's “nucleated” glasses helps sustain a foamy beer head. She tells a manager it's time to consider using IV-style bags to get sauce into the shaking pails. She describes how her research into competing chains made her decide that none of her restaurants would pay more than 13.1 percent of revenue for rent and depreciation.

The company started in 1982 with one restaurant in Columbus, Ohio. When Smith joined as CFO in 1994, Wild Wings had about 30 locations, no financial statements, and no computers. “We hired someone to do payroll because she had a typewriter,” she says. The company did most of its own shipping. “If we wanted to open a new store, we had to decide whether to buy a new truck.” A man hired as CEO in 1996 never showed up for work. “One of

the directors said, ‘I guess you're going to have to do it,’” Smith recalls.

As she cleaned up the books and ditched the shipping operation, Smith often wondered what she'd gotten herself into. “But I knew there was something there,” she says. Buffalo wings were still a novelty. “I'd talk to guests, and they'd say they're coming in three or four times a week for the wings.” College students wrote to ask when a Wild Wings would open near their campus.

The restaurants focused on sports as younger customers came to watch cable and satellite channels they couldn't afford at home. “Somebody from Ohio State would say, ‘Would you put on the game?’” Smith says. Wild Wings became an early adopter of flatscreens and high-definition TV. By the time its first national ad ran on ESPN, in 2006, the chain had 400-plus locations and was adding 50 to 60 a year.

Then the recession hit, pushing most casual-dining restaurants into a slump from which few have emerged with any real vigor. The sit-down operations couldn't compete with McDonald's and Burger King on price, and fast-casual alternatives such as Chipotle and Panera Bread lured away millennials with fresh dishes, lower prices, and speedier service. Yet Wild Wings' growth actually increased during the downturn, partly because it emphasized more than food. While TV spots for Chili's and Applebee's touted tumbling salads and juicy steaks at cut-rate prices, goofy B-Dubs ads suggested it would keep the sports revelry going by secretly manipulating game outcomes. Wild Wings looked fun, and cost-conscious families saw it as a twofer, says Jennifer Bartashus, a Bloomberg restaurant industry analyst: “If you're going to spend \$40 on your family, the lure of being able to entertain yourself at the same time is strong.”

The Germantown B-Dubs, restaurant No. 1,050, opened three days before Thanksgiving 2014. On the morning before the Sweet 16 contest, the restaurant's general manager, Jillian Cabanatuan, gathers 16 workers in a pregame huddle. Most wear gray-and-yellow jerseys marked “82,” the year the company was founded. Cabanatuan is expecting a packed house. In addition to Wisconsin-North Carolina, customers will be coming for “Boneless Thursday” discounted wings. Some of Cabanatuan's crew will work through the night. “It's going to be a long day,” she tells them. Everyone touches hands and shouts, “1-2-3, B-Dubs!”

Buffalo Wild Wings is built for big sports events, especially March Madness. The company sold more than 100 million chicken wings during this year's tournament, easily topping the 94 million sold last year. Moving that many wings is



Wisconsin fans cheer on the Badgers at the Buffalo Wild Wings in Germantown

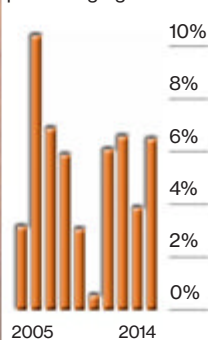
nowhere near as economical as it was a decade ago, before chicken wing prices became exceptionally volatile. “‘Wild wings’ is pretty much a description of the market,” says agricultural industry consultant Thomas Elam of FarmEcon. A U.S. Department of Agriculture chart showing wing prices for the past five years resembles a roller coaster, climbing and diving by as much as a buck a pound, hitting bottom at about 76¢ in 2011 and topping out at \$2.04 in 2013. A year ago, Wild Wings was paying \$1.36 a pound for traditional wings, including freight and handling charges. Lately the price has risen to \$1.90. Managing the volatility is crucial, because wings account for about a quarter of Wild Wings’ costs. The popularity of boneless wings—actually breast meat shaped like a wing—has helped smooth out the bumps. The company buys its boneless meat on long-term contracts; wings are purchased on rolling arrangements under which prices change monthly.

Chickens are raised mainly for breast meat. Producers decide how many birds go to market depending on demand, rainfall, feed costs, and whether foreign customers are limiting U.S. imports. Producers in the past decade have been growing plumper birds to take advantage of lower feed costs. That means meatier wings—but still no more than two per chicken. Shipments that once brought 10 wings per pound suddenly had just six or seven. Wild Wings responded by changing its menu from per-piece servings to four order sizes: snack, small, medium, and large. The number of wings in an order might vary by one or two depending on the size of the pieces. Wild Wings has already raised prices to offset increasing costs and has said it will do so again this year.

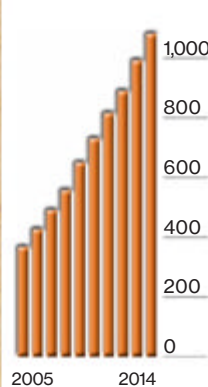
Commodity wing prices are often the first thing analysts ask about on Wild Wings’ earnings conference calls. Partly to calm Wall Street, the company is changing the way it buys wings. Until now, the price has been determined by the average daily price for the prior month as reported by Urner Barry, a commodities markets news service. A new arrangement with suppliers, starting on April 15, will set a ceiling and a floor on prices. Smith, while declining to specify the range, says the company and its suppliers will share the pain or benefit when wing prices move outside of it. She also has some free advice for speculators looking to get rich quick: Anyone who can pinpoint why wing prices

Same-store sales

Year-over-year percentage growth



Number of stores



fluctuate so much “can make a lot of money.”

Perhaps Wild Wings’ toughest challenge is attracting customers when the sports calendar is thin. Last year it hired a new advertising agency, TBWA\Chiat\Day, to create 10 TV spots for March Madness. The ads star Steve Rannazzisi, from the FX comedy *The League*, who cracks wise about the excitement and trivia games (sample question: “How did the term ‘bandwagon’ originate?”) at Buffalo Wild Wings. In one spot, Rannazzisi eats a wing while warning against DVRing games, because if they go into overtime... whereupon the ad freezes, making viewers think their DVR actually screwed up. “Our Facebook page lit up with people saying, ‘You got me,’” says Bob Ruhland, vice president for marketing at Wild Wings.

The campaign has a “Good-night Madness” spot scheduled to air after the final. Viewers will begin seeing a non-NCAA commercial starring William Zabka, who played the towheaded bully in *The Karate Kid*. It’s part of a summer push to draw people in for less popular sports such as skateboarding and rugby. The company will need that traffic to approach summer 2014 sales, which were boosted by World Cup soccer.

Last August, Wild Wings launched GameBreak, an app for fantasy football and other games that can be played inside or outside the restaurants. Almost 200,000 users have registered. Nelsen, the company’s innovation executive, says players are more likely to visit more often, stay later, and “buy that second or third beer or maybe one more basket of wings.”

Lunch is also an issue. If the company wants to reach its goal of doubling average store sales in 10 years, it can’t rely solely on adding locations. “Lunch has to play a bigger part,” Smith says. Midday clientele now account for about a fifth of Wild Wings’ business. Increasing that share will require matching the service speed of Chipotle. Plus, lunchtime alcohol sales are low, and there aren’t many sports events that time of day to draw fans. The company is introducing a simplified menu of dishes that can be prepared faster, including a taco-like chicken “buffalito” and a prime rib sandwich, and it’s training employees to deliver more quickly during the afternoon.

A new layout meant to make the restaurants feel like miniature stadi-

ums should help all parts of the day, Smith says. Since 2013, Wild Wings and its franchisees have spent more than \$200 million building 118 of these “stadia” restaurants, including the one in Germantown. Stadia Wild Wings have more windows and natural light than the older locations. The seating area is arranged around a U-shaped central bar, which is moved away from the wall and has huge TVs hanging overhead. Wild Wings’ designers worried the new setup might alienate families with children. “There was a lot of debate about that,” says Thomas Berzinski, vice president for real estate. “Some families don’t want to feel like they’re sitting at a bar.” But the gigantic screens—“jumbotrons,” Wild Wings calls them—enable seating at a distance while providing a focal point for everyone if, say, the Green Bay Packers are playing. Local touches also help, such as the framed blue-and-gold Germantown High School jerseys hanging on the walls.

It’s too early to tell if the new restaurants will be worth the investment, though Smith says so far they’re meeting her expectations. While the surroundings are important to keeping both families and singles coming in, she says, “The food still has to get into the restaurant, and you have to have friendly, helpful employees.”

Late in the second half of the Wisconsin-Carolina game, Glover and his colleagues are still shaking sauce pails, and waitresses wearing red beads and temporary Badger face tattoos are hustling trays of food and drinks. By the end of the night, the Germantown B-Dubs will have sold 8,500 wings, a bit less than half the morning’s delivery.

The audio feed booms from 40 speakers. Most of the kids who were mugging for photos with Blazin’ Bill, B-Dubs’ buffalo-headed mascot, have left with their parents. Two customers in Carolina blue watch as the Tar Heels’ lead dwindles.

Paul Tews and his pal Steve Schraufnagel have been at their bar stools since an hour before tipoff. They arrived in Wisconsin red, ate a pile of wings, lost some free raffles for gift cards, and watched guys with sauce-slicked faces compete in a wing-eating contest. The wings and beers are OK, they say, but they really enjoy being part of the party. “It’s fun coming here,” Schraufnagel says. “I just hope those guys in blue-and-white aren’t happy at the end of the night.”

The din swells as the game clock winds down. With 6:08 to go, Wisconsin point guard Zak Showalter, who played for Germantown High, makes a layup to put the Badgers ahead. The place explodes with cheers. Tews and Schraufnagel jump up and high-five. Wisconsin wins. The buddies sit back down and order another round. **B**

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EVIL
BOSSSES

NON-UGLY OFFICE CHAIRS

EAT SOME
JERKY

SUZY
WELCH TELLS ALL

ETC

A photograph of Franklin Leonard, a man with dreadlocks, wearing large headphones and speaking into a professional microphone in a radio studio. He is sitting at a desk with various pieces of equipment, including a lamp and a wooden box with a 'S' logo. The background is a mix of wood paneling and acoustic foam.

Hear the Movies You Can't See

With the *Black List* podcast, Franklin Leonard

brings Hollywood's best unproduced scripts to life

By Caroline Winter

Photographs by Julian Berman

M

alcolm Spellman and Tim Talbott, a screenwriting duo known as the Robotard 8000, sit on canary-yellow chairs in a Hollywood studio discussing their darker days. “Both of us were dead,” Spellman says. Back in 2008, after a few decent years in the industry, work had dried up.

“Our reaction was to flex our s--- to the max,” recalls Spellman, now a writer on *Empire*, the hit Fox TV show. The two friends are being interviewed by Franklin Leonard, host of a new weekly podcast, *The Black List Table Reads*, which features dramatic readings of Hollywood’s best unproduced screenplays. Leonard, who’s become a patron saint for movie writers over the past decade, is partly responsible for reviving the Robotard 8000.

Film development executives are always searching for new material, but it’s tough to trust unvetted talent with multimillion-dollar projects or gauge the potential of more offbeat stories. So in 2005, Leonard started his *Annual Black List*, which highlights the year’s best-liked unproduced scripts, as nominated by more than 300 industry insiders. “We’re just as interested in identifying scripts that are tiny but well-written as we are in box office material,” he says. Sometimes his discoveries are both: Ben Affleck found the script for *Argo* on the list; it went on to win the Oscar for Best Picture.

At first, Leonard’s hobby occupied him for three weeks each December. Now he’s made it a business that employs five people. In addition to the survey, which earns nothing, he’s introduced *blcklst.com* to connect screenwriters with and without agents to producers looking to make films. Writers pay \$25 a month to have a script hosted and \$50 for a professional evaluation. (Leonard’s company keeps half; the rest goes to the evaluators.) So far, more than 20,000 scripts have been uploaded.

“It used to be a closed-loop system where, if you didn’t have an agent, you were pretty much screwed, because nobody would read your material,” says Scott Myers, author of the screenwriting blog *Go Into the Story*. “Franklin’s created an alternate to the

old, very narrow, confined way of getting in.” Studios such as Warner Bros. and Walt Disney have hired writers directly from *blcklst.com*, and a few scripts written by nobodies have made it from the all-access site onto the exclusive *Annual Black List*.

The podcast, which will come out on April 16, is an attempt to get nonindustry fans involved long before a script gets bought, filmed, and distributed to megaplexes. It should appeal to the same people who, while they may not work in Tinseltown, love movies enough to follow trade websites such as *Deadline* and the *Hollywood Reporter*, both of which revere the *Annual Black List* as if it’s a sacred document. The podcast is being co-produced by Midroll Media, a podcast company that works with hosts including Marc Maron, Neil deGrasse Tyson, and Paul Scheer, who runs Wolfpop, an entertainment-focused network.

Each month, Leonard will choose a script and Scheer will help supply actors from his Wolfpop entourage, including maybe-familiar voices like Lauren Lapkus, Jason Mantzoukas, and other actors who’ve appeared on *Orange Is the New Black*, *Parks and Recreation*, and other shows. Featured writers will keep full rights to their scripts while making

50 percent of any ad revenue earned from the podcast. “If their episodes are popular, they may get a massive windfall,” Leonard says. He also sells \$25 tickets for live readings of some *Black List* scripts.

The Robotard 8000 screenplay *Balls Out* will be the first one featured. The profanity-laced comedy centers on insurance salesman Jim Simmers, who, after a near-death experience, finds out there’s no

afterlife. He goes on a screw-the-world rampage to get a promotion, a new car, and the hot girl at work. It was an obvious choice, Leonard says: “It’s very much a

male-driven comedy and simultaneously a brilliant satire of one.”

When Talbott and Spellman finished *Balls Out* in 2009, their agents refused to send it out, deeming it too gross. “My manager was like, ‘I would have to get special permission from the head of the company to be able to put our covers on a script this foul,’” Talbott recalls. At a friend’s suggestion, the duo created a rudimentary website that “looked like it had been built by a retarded robot”—hence the name—and posted the script online. Some



Top and opposite: A live reading with Leonard. Above: The cast after a recording of *Balls Out*

movie executives found it and began passing it around. Within about nine months, *Balls Out* had enough support to land it on the *Annual Black List*. Since then, it's been optioned by a production company but not yet filmed. Talbott and Spellman are psyched enough that it's going live as a podcast. "Anytime you're affiliated with the *Black List* it's a good thing," Spellman says. But, he adds, "until very recently, I thought podcasts were for nerds."

He's not incorrect. Radio dramas have been around since the 1920s. They were popular entertainment in the 1940s, then died off when color TV took off in the '50s. Now audio entertainment is making a comeback, fueled by the proliferation of podcasts such as NPR's *Serial*, which set an iTunes record last year when it was quickly downloaded more than 5 million times. About 17 percent of Americans listen to podcasts each month, up from 9 percent in 2008, according to Edison Research. The average listener tunes in to six each week.

Several podcasting companies have popped up, including Slate's Panoply, Gimlet Media, and Midroll. On each, advertisers generally pay from \$15 to \$25 per 1,000 downloads. That's more than three times as much as for many radio ads, largely because podcast blurbs, most of which are read or ad-libbed by hosts, are invasively effective. "People are really engaged with the content and the host," says Adam Sachs, chief executive officer of Midroll. He's found that 63 percent of people bought something after hearing it advertised on a podcast.

"I'd be lying if I said I wasn't incredibly nervous about doing the podcast," Leonard, 36, admits. Before this, he's always been behind-the-scenes. After graduating from Harvard in 2000, he worked on a congressional campaign in Ohio, then as a McKinsey consultant in New York. When his entire analyst class was let go in 2002, he had five months of severance pay and lots of free time. One night in February 2003 he watched three of his favorite films—*Being There*, *Amadeus*, and *Dr. Strangelove*—then spontaneously booked a ticket to Los Angeles. "I realized I was spending all my time either reading about the film industry or

watching movies," he says. The same week he landed in L.A., he interviewed with a talent agent at Creative Artists Agency and was hired as an assistant.

His list was born two years later as he grew frustrated reading piles of mediocre scripts. Looking to access better material, Leonard anonymously queried 75 colleagues and asked them to send their favorite screenplays. He compiled the replies, then sent out the resulting list, calling it the *Black List*. The name is a nod to Hollywood writers who were

barred from working during the McCarthy era and an inversion of

assumptions about race. "It's a black list people want to be on," Leonard says. A week after sending out the e-mail, he returned from vacation and found his list had been forwarded back to him more than 50 times, like a viral chain letter, by people oblivious he'd created it.

The *Annual Black List* still works the same way, though more experts are queried and everyone in Hollywood knows Leonard is in charge. Since its inception, 987 scripts have made the list, of which 295 have been filmed, including *The Imitation Game* and other hits such as *Slumdog Millionaire* and *The King's Speech*. Those produced have collectively received 223 Oscar nominations and 43 wins. Leonard's company doesn't take a cut when a movie gets made. "We don't want to insert ourselves where we aren't adding any value," he says.

The aim, Leonard says, is to ensure more good scripts get attention. In mid-March, during the taping of *Balls Out*, he follows along on his MacBook, trying to stifle his laughter so it doesn't end up on the recording. After the session ends, Leonard lets out a sigh of relief. "I think that went well," he says. "I'm excited by the medium, because it doesn't require \$100 million to make." One day, he adds, the *Black List* may expand into the business of actually making films. "But for right now, I can contribute more to great movies getting made this way."

As for the Robotard 8000? The duo is working on a sequel to *Balls Out*. Spoiler alert: Islamic State terrorists take control of Cape Cod. **B**

“Franklin’s created an alternate to the old, very narrow, confined way of getting in”



Etc.

Design

Sitting Pretty

*Collaborate more stylishly
using these lightweight “guest” chairs*
By Monica Khemsurov

Dressed First chair by Stefano Giovannoni for Magis

\$1,080; hermanmiller.com

It's wrapped entirely in comfortable fabric, though much sleeker than your average upholstered version. Choose a few in a vibrant color—lime, fuchsia, and so on—to brighten a startup's lobby.



ErgoErgo stool by Alan Heller

\$100; momastore.org

A flat take on the exercise ball, the stool has flexible plastic that rocks back and forth to encourage you to tighten your core for stability as you sit. Try it if you work at a white-shoe firm; it will contrast well.



Maruni Hiroshima chair by Nato Fukasawa for Maruni

\$1,290; citenyc.com

An update on the plastic folding chair made in Japan from lightweight beech. It would look great in a glass space—you could even rest it against the wall as décor. The designer's best known for his work with Muji, the affordable office-supply company. Sadly, this one's less cheap.



Stool 60 by Hella Jongerius for Artek

\$300; artekstore.com

Alvar Aalto designed this bent-leg birch model in 1933, and it's since become a classic. Last year, Finnish brand Artek let Jongerius redo the seat in colors and finishes such as turquoise and metallic silver. It's stackable and perfectly basic—sit on it, put your feet up on it, or lean over it to eat lunch.





**Morph stool
by Formstelle for
Zeitraum**

\$1,130; suiteiny.com

Technically, this is an ottoman—it looks like a milking stool—but it works just fine as a seat. Spring for the comfy cushioned version to add a bit of corporate polish.

**Hal armchair by
Jasper Morrison
for Vitra**

\$750; vitra.com

Morrison's known for his minimalist take on everyday objects. At 13 pounds, this one resembles an Eames shell chair but with less material and an airier feel. Conference room gold!

Vapor chair

\$179; cb2.com

Made from one continuous curve of acrylic atop a chrome-plated steel frame, it blends well with standard-issue gray office furniture.

The transparent material will prevent your tiny cubicle from looking too cluttered.

**CH88 chair
by Hans Wegner for
Carl Hansen & Son**

\$720; suiteiny.com

Until last year, this 1955 design existed only as a prototype. It's ideal for private offices: The upturned curves on the backrest give a nervous interview candidate a spot to rest her arms.

GOOD BOSS, BAD BOSS

Seven executives on the managers that made—or stalled—their careers

By Arianne Cohen

“My boss at a consulting company shaped my management philosophies, including ‘Play offense, not defense,’ so we’re forward-thinking and aggressive. Whenever I’m stuck, I remember how he challenged me to shift the rules.”

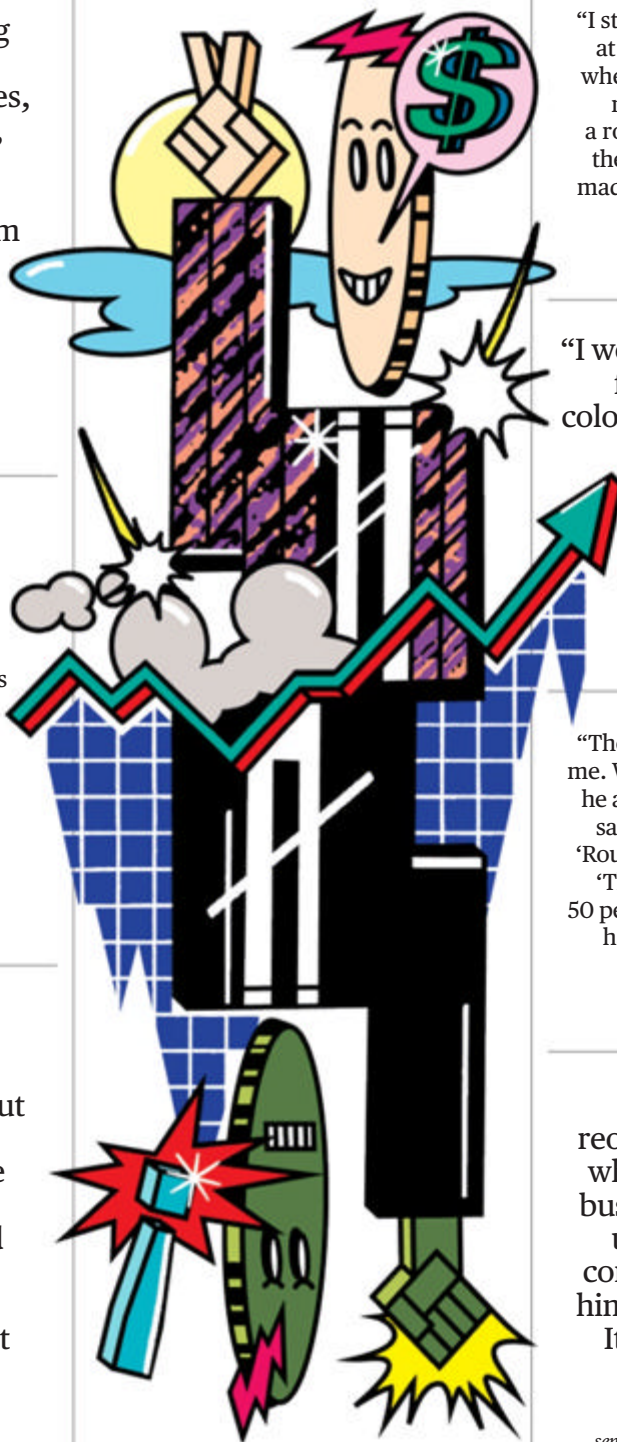
Charlie Young,
president and chief executive officer,
ERA Real Estate

“I like to say I received a master’s degree from B.C., which are the initials of the former COO of Starwood Hotels. I replicate many of his habits: I host regular outings at my home for my team and their families, and I hire team members who have very different skill sets from me.”

Hoyt Harper II,
senior vice president for
global brand management, Sheraton
Hotels & Resorts Group

“She was so good that I worked with her twice. She was clear about the problems we had to solve and gave us the license to explore creative solutions. I did some of my best work with her, because she inspired innovation, not demanded it.”

Leslie Dukker Doty,
chief marketing officer, Reader’s
Digest Association



“I still remember a senior executive at a large bank barking, ‘Think!’ when she didn’t like my work. As a mother, she could have been a role model for young women in the finance industry. Instead, she made me feel unsure of my career.”

Jennifer Fleiss,
co-founder, Rent the Runway

“I worked for an architectural firm and was asked to color drawings for clients. My pencil strokes went in all directions. The boss was furious and tore them all up.”

Chris Kormis,
associate dean, McDonough School of
Business at Georgetown University

“The head of a hedge fund recruited me. When we were negotiating salary, he asked how much of my previous salary I needed, and I answered, ‘Roughly half.’ I expected him to say, ‘That’s silly. You shouldn’t take a 50 percent cut.’ He didn’t—he gave me half. I resented that until I left.”

Douglas Merrill,
CEO, ZestFinance

“My team of 20 was reorganized under a leader who knew little about our business and didn’t engage us. Support was never coming, so I learned to tell him what the team needed. It’s a lesson I’ve carried through my career.”

Catherine Courage,
senior vice president for customer experience,
Citrix Systems

RUBY BAY TERIYAKI SALMON

\$4.99 for 1.25 ounces

Acme, a famed purveyor of smoked fish in Brooklyn, N.Y., recently introduced this line. Try the teriyaki, which uses smoked Alaskan King salmon seasoned with soy sauce and brown sugar before it's dehydrated.



TRADER JOE'S SWEET SRIRACHA UNCURED BACON

\$5.49 for 2 oz.

Honey, garlic, and sriracha-style hot sauce are used to cure these exceptionally juicy bacon pieces. They're fully cooked, so they aren't overly chewy.



GARY WEST ELK

\$18 for 4 oz.

The strips are made from antibiotic-free top round elk steak, marinated and smoked slowly over pear and hickory chips. It's a little tough to chew—but still delicious if you like game meat.

KRAVE HONEY PEACH BBQ PORK

\$9 for 3.25 oz.

Sonoma (Calif.) jerky specialist Krave, in collaboration with Whole Foods, sources pork from farms with the highest animal welfare standards, then infuses it with honey peach barbecue sauce. A nice smokiness balances the sweetness.



FIELD TRIP CRUSHED CHILIES TURKEY

\$6.50 for 2.2 oz.

Field Trip's newest turkey jerky is flaming hot—if you don't like chilies, try the milder cracked pepper variety. Both are made without nitrates, preservatives, or high fructose corn syrup. They're low in calories, too.



GOLDEN VALLEY NATURAL BUFFALO

\$8.99 for 3 oz.

Want a meatier flavor? Tender buffalo creates a supple jerky, with savory and smoky undertones from a marinade of apple cider vinegar and paprika.

KAIMANA TERIYAKI AHI TUNA

\$7 for 2.75 oz.

This hand-cut jerky is made on the Big Island of Hawaii from wild-caught premium ahi tuna, drenched in Kaimana's homemade teriyaki sauce, then slowly dried. It's softer and more pliable than the others.

WHERE'S THE BEEF?

Jerky is back, thanks to paleo dieters and purveyors who prove that nonbovine meats taste just as good spiced, smoked, and dried. By Elizabeth G. Dunn

MUSIC FOR THE ONE PERCENT

Testing out Jay Z's expensive new streaming service

By Claire Suddath



If you subscribe to the music service Tidal, you can listen to a playlist of Jay Z's favorite songs. Right now he's into Kanye West, and the rapper Kendrick Lamar, and an obscure Outkast song from the 1990s that was never a hit. The track list is displayed prominently on the app, of course, because Jay Z owns Tidal: He purchased it earlier this year from the Swedish company Aspiro for \$56 million. On March 30, in a press conference that featured Beyoncé, Rihanna, Taylor Swift, and other pop stars hilariously signing what looked like a presidential bill, Jay Z declared that he's disrupting the music industry. Actually, he had Alicia Keys make the proclamation for him.

For \$10 a month—or \$20 if you want high-fidelity audio files, which sound no better on most headphones—Tidal gives you access to a catalog of artist-curated music. Jack White chose a bunch of weird stuff from his record label Third Man Records. (Gene Clark? A guy named Pokey LaFarge?) Jason Aldean made a list of country party anthems that includes Kid Rock. Beyoncé

can't wait to see her friend West at this summer's music festivals. You can also make playlists yourself; Tidal has about 25 million songs to choose from.

This would be great if it didn't already exist. It's called Spotify, the preeminent service that offers more than 30 million songs for free to 60 million users (15 million of whom pay \$10 for ad-free listening). Since first going live in 2014, Tidal has wooed only 500,000 paying customers. Clearly the new boss

thinks copying the competition will get those numbers up.

Tidal's redone app is easy to navigate and uses the same white text and black background as Spotify. If you had both apps

open on your phone, you might forget which is which.

Jay Z, who's owned nightclubs, basketball teams, and other entrepreneurial trinkets, insists Tidal's business plan will set it apart. As Keys announced at the event, Tidal is "the first ever artist-owned global music and entertainment platform." These "artists" are all platinum-selling musicians; Nicki Minaj, Madonna, and

Coldplay's Chris Martin are among Jay Z's 15 investors. He hasn't yet outlined his pay structure or said how much regular musicians—who don't get the chance to invest—stand to make from his service, but a manifesto posted on the app promises to "reestablish the value of music" and protect "the sustainability of the music industry," as if pop songs are on the verge of extinction.

Spotify, based in Sweden, pays artists from 0.6¢ to 0.84¢ per play, which is chicken feed for a struggling act. But for a star who garners millions of streams, the half-pennies add up. Last year, Swift made as much as \$2 million on Spotify before she pulled her songs off it completely. (Her label says it was more like \$500,000.) Now Swift's catalog is back online through Tidal, minus her latest album, *1989*, which she still prefers to sell for \$13 on iTunes.

It's tough to get listeners excited about paying artists more money. So Tidal's also touting lots of non-audio content. As of the relaunch, there's a collection of video perks, such as *Daft Punk's Electroma*—a 74-minute movie so boring that people walked out when it aired at the Cannes Film Festival in 2006—and a strange, low-res video clip of the White Stripes' first televised performance on a Detroit public access show. Too bad you can already find both these things, for free, on YouTube.

Over time, this exclusive content may become legitimately exclusive. The Swedish website Breakit says Tidal's new team plans to broker deals with labels that allow it to release music before anyone else. West is supposed to drop a new album this year, and it will be a huge win if it lands on Tidal first. Still, Yeezy isn't stupid—even if an album premieres on Jay Z's app, it will eventually show up on all the larger streaming platforms, too.

And so Tidal will probably fail to breach Spotify's stronghold. If anything, the service is vying for second place against Beats Music, now owned by Apple, which similarly specializes in curated playlists for customers who pay as much as \$99 annually. That's assuming there's a place in this world for another nice-looking, ultimately uninspiring rip-off of something that already works well. Even if you've never tried Spotify, why would you pay more money for the same music—and some odd videos—that you can get anywhere? So what if you miss out on Tidal's recommendations from Coldplay: The band picked out Oasis's *Champagne Supernova* and TLC's *Waterfalls*. That's not even worth half a penny. **B**

What's Intelligent Nutrients?

A line of skin-care and lifestyle products made of pure ingredients that are certified organic. We want to influence other brands to be transparent and show their ingredients.

How'd you get into this?

My father, Horst Rechelbacher, started Aveda, which we sold to Estée Lauder in 1997. We kept Intelligent Nutrients, then a supplement company. I'm grateful that I'm partners in this with his wife.

You probably didn't have to take on this job.

It's fulfilling. That's what it is.

NILI LOTAN

How do you get dressed?

I pick out an essential oil first—my fragrance. We make them. It really tops off an outfit, because it hits the senses: First people see you, then they come into your space and your smell.

Those are bold pants.

It's kind of dark here in Minnesota, so I often want something white.

Are those high heels?

Not too high—they're perfect. I love the way tower heels look, but I just can't stand.

BALMAIN

That's quite a power jacket.

I always have an investment piece. This has great tailoring that you can't often get.

Is that a hoodie underneath?

Essentially. We're in a warehouse, and it gets really chilly.

What's your beauty background?

I studied at Vidal Sassoon and used to work shows with my dad as a teenager.

Any hairdressing advice?

There are no rules in hairdressing. Or in fashion.

**ORGANIC
BY JOHN PATRICK**

NICOLE RECHELBACHER

47, co-owner and
co-president, Intelligent Nutrients,
Minneapolis

ISABEL MARANT



SUZY WELCH

Author, speaker

At the *Miami Herald* in 1981

Posing (second from right, at age 4) with her siblings in 1963



"Some was part-time or project-based. I started having children—I have four—and they were unbelievably good in accommodating me."



At Bain with her firstborn, Roscoe, in 1990

"I interviewed Jack [Welch], and we liked each other a ton. I realized I had to pull the article, and I got fired. We didn't become involved right away, despite what everyone said. I was divorced at the time, but Jack was not."



Her wedding to Jack Welch in Boston in 2004

"I had no idea what it was to be a public person. I thought that people would say, 'Gee, they must be really in love.' I was quite stunned. It was the most shocking thing that happened in my life."

Education

Phillips Exeter Academy, Exeter, N.H., class of 1977

Harvard College, class of 1981

Harvard Business School, class of 1988

Work Experience

1974
Cashier, Cumberland Farms

1981–83
Reporter, *Miami Herald*

1983–86
Business reporter, overnight supervisor, the Associated Press

1988–95
Consultant, Bain & Co.

1995–2002
Senior editor, editor, *Harvard Business Review*

2002–Present
Writer, public speaker, TV commentator

2005
Co-author, *Winning*

2010–11
Director of marketing, the Jack Welch Management Institute

2015
Co-author, *The Real-Life MBA*

Life Lessons



"I was an absolute gumshoe cop reporter. I had a police radio and eight police headquarters to cover."



"It's an unbelievably intense experience to write a book with your spouse."

In Rome, while working on a book in 2003

"Every night, Jack had to talk me out of a tree. I am not cut out to be an entrepreneur. He finally had to fire me, and now the school is massively successful—900 students—with no thanks to me."

"It's a no-b.s. guide to winning strategically, building a great team, and getting your career out of the pile."



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